DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

September 5, 2018

Sara Kaiser Creighton
Elizabeth France
John E. Bies
American Oversight
1030 15th Street NW, Suite B255
Washington, DC 20005
foia@americanoversight.org

Re: *American Oversight v. U.S. Department of the Treasury*, 17-cv-2078-RBW (D.D.C.): Treasury September 5 Production

Counsel:

This letter describes the September 5, 2018 production from the U.S. Department of the Treasury (Treasury) in the above-referenced Freedom of Information Act litigation. Pursuant to the Court's February 2, 2018 Order, Treasury has reviewed and processed 60 documents collected in response to American Oversight's Congressional Communications FOIA Request, 2017-08-121. Via email, Treasury is producing 20 documents totaling 34 pages, comprising the non-exempt, responsive portions of the records within this collection. The documents are numbered UST 000875 - 908; portions of these materials are withheld pursuant to Exemptions 5 and 6 of the FOIA. An additional 36 documents, totaling 226 pages, are being withheld in their entirety pursuant to Exemption 5, and four documents are non-responsive and/or duplicative of other materials within this collection and are therefore not being produced.

Treasury is continuing to review records that are potentially responsive to this request and will respond to you again on or before October 5, 2018.

If you have any questions concerning this production or a related matter, please contact Rebecca Kopplin, U.S. Department of Justice, at (202) 514-3953.

Sincerely,

Ryan Law
Office of Privacy, Transparency, and Records
U.S. Department of the Treasury

Staff Summary

From:	"Knight, Shahira E. EOP/WHO" Shahira Knight, EOP [redacted]>
To:	"Brendan M. Dunn (Brendan_Dunn@mcconnell.senate.gov)" <brendan_dunn@mcconnell.senate.gov>, "Callas, George" <george.callas@mail.house.gov>
Cc:	"Muzinich, Justin" <justin.muzinich@treasury.gov>
Date:	Tue, 19 Sep 2017 18:43:10 -0400
Attachments:	Big 4 Staff Consensus Summary - Treasury NEC Edits.docx (38.23 kB)

We took the liberty of converting the document into Word format so we could edit it. The attached reflects comments from Treasury and NEC.
It is not as heavily edited as it appears. There is a lot of redlining because we deleted the tables, moved one section and had some wordsmithing changes. We also have several questions as we didn't understand the context of some of the language and numbers in here. Thanks.

Re: Tax Education

From: "Dunham, Will" <will.dunham@mail.house.gov>
To: [redacted]@treasury.gov>
Cc: "Bailey, Bradley" <bradley.bailey@treasury.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>, "Kellogg, Matthew" <matthew.kellogg@treasury.gov>, "Specht, Brittan" <brittan.specht@mail.house.gov>
Date: Tue, 19 Sep 2017 18:44:23 -0400

Super thank you!

Sent from my iPhone

On Sep 19, 2017, at 6:43 PM, [redacted]@treasury.gov" <[redacted]@treasury.gov> wrote:

Great. Please meet at Drew's Office – Main Treasury 3134 at 8AM and then can walk down to the dining room.

From: Dunham, Will [mailto:Will.Dunham@mail.house.gov]
Sent: Tuesday, September 19, 2017 6:40 PM
To: [redacted]@treasury.gov>
Cc: Bailey, Bradley <Bradley.Bailey@treasury.gov>; Maloney, Drew <Drew.Maloney@treasury.gov>; Kellogg, Matthew <Matthew.Kellogg@treasury.gov>; Specht, Brittan <Brittan.Specht@mail.house.gov>
Subject: Re: Tax Education

Thanks Casey. Brittan and I can do that. I'll send you my info directly.

Sent from my iPhone

On Sep 19, 2017, at 6:35 PM, '[redacted]@treasury.gov" <[redacted]@treasury.gov> wrote:

Hi Will,

Hope you are doing well! Any chance you can do a 8AM breakfast? We can host at Treasury, but will need the information below asap.

First, Middle, and Last Name
DOB
Y/N US Citizen
SSN
Country of Birth
City and State of Residence

From: Bailey, Bradley
Sent: Tuesday, September 19, 2017 5:55 PM
To: Dunham, Will <Will.Dunham@mail.house.gov>
Cc: Maloney, Drew <Drew.Maloney@treasury.gov>; Kellogg, Matthew <Matthew.Kellogg@treasury.gov>; [redacted]@treasury.gov>
Subject: Re: Tax Education

Adding [redacted]

From: Dunham, Will <Will.Dunham@mail.house.gov>
Date: September 19, 2017 at 5:38:12 PM EDT
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>
Cc: Maloney, Drew <Drew.Maloney@treasury.gov>, Kellogg, Matthew <Matthew.Kellogg@treasury.gov>
Subject: Re: Tax Education

It'll take me half an hour at least to get there and get in the building if I leave right now - let's do it tomorrow AM. I'm flexible in the morning. Adding Brittan.

Sent from my iPhone

On Sep 19, 2017, at 5:28 PM, "Bradley.Bailey@treasury.gov" <Bradley.Bailey@treasury.gov> wrote:

> Prob 6:30 if you want or we could do tomorrow
>
> ---
>
> **From:** Dunham, Will <Will.Dunham@mail.house.gov>
> **Date:** September 19, 2017 at 5:20:34 PM EDT
> **To:** Bailey, Bradley <Bradley.Bailey@treasury.gov>
> **Cc:** Maloney, Drew <Drew.Maloney@treasury.gov>, Kellogg, Matthew <Matthew.Kellogg@treasury.gov>
> **Subject:** Re: Tax Education
>
> You're thinking meeting tonight in person? How late are you guys in?
>
> Sent from my iPhone
>
> On Sep 19, 2017, at 5:16 PM, "Bradley.Bailey@treasury.gov" <Bradley.Bailey@treasury.gov> wrote:
>
>> Will--just tried giving you a call. We can do something this evening if that still works for you. 202-615-2125
>>
>> ---
>>
>> **From:** Dunham, Will <Will.Dunham@mail.house.gov>
>> **Date:** September 19, 2017 at 10:34:30 AM EDT
>> **To:** Kellogg, Matthew l<Matthew.Kellogg@treasury.gov>
>> **Cc:** Bailey, Bradley <Bradley.Bailey@treasury.gov>, Maloney, Drew <Drew.Maloney@treasury.gov>
>> **Subject:** RE: Tax Education
>>
>> Happy to come down at your convenience. Free noon-3 today and after 5. I'd bring Brittan along.

From: Matthew.Kellogg@treasury.gov [mailto:Matthew.Kellogg@treasury.gov]
Sent: Tuesday, September 19, 2017 10:29 AM
To: Dunham, Will <Will.Dunham@mail.house.gov>
Cc: Bradley.Bailey@treasury.gov; Drew.Maloney@treasury.gov
Subject: Tax Education

Will – Following up on our discussion. Any chance you'll be down this way in the near future so we could have a quiet conversation of how to be helpful on tax reform education efforts?

Thanks.

-Matt

Matt Kellogg
Deputy Assistant Secretary for Banking and Finance
Office of Legislative Affairs
Department of the Treasury
Matthew.kellogg@treasury.gov
202.622.1900

Re: Big 6 Comms Meeting

From: "Sayegh, Tony E. EOP/WHO" Tony Sayegh, EOP [redacted]>
To: "Buck, Brendan" <brendan.buck@mail.house.gov>
Cc: "Dorr, Kaelan K. EOP/WHO" Kaelan Dorr, EOP [redacted]>, "Ferrier, Antonia (McConnell)" <antonia_ferrier@mcconnell.senate.gov>, "Schillinger, Emily" <emily.schillinger@mail.house.gov>, "Lawless, Julia (Finance)" <julia_lawless@finance.senate.gov>, "Ditto, Jessica E. EOP/WHO" Jessica Ditto, EOP [redacted]>, "Strong, AshLee" <ashlee.strong@mail.house.gov>, "Andres, Doug" <doug.andres@mail.house.gov>, "Popp, David (McConnell)" <david_popp@mcconnell.senate.gov>, "Stewart, Don (McConnell)" <don_stewart@mcconnell.senate.gov>, "Knight, Shahira E. EOP/WHO" Shahira Knight, EOP [redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Wed, 20 Sep 2017 05:58:44 -0400

Thanks Brendan. This is the exact right list of action items. I know it's ambitious to execute all this in 30 minutes so I would suggest we view the first 30 as Comms only discussion b(5) [redacted]

Then we can spend time w broader group which will include b(5) [redacted]

b(5) [redacted]

Sent from my iPhone

On Sep 19, 2017, at 5:02 PM, Buck, Brendan <Brendan.Buck@mail.house.gov> wrote:

> Hey folks, sorry for delay. I know we only have 30 minutes for the comms portion of the meeting, but these are the things I think we need to work through for next week.
>
> b(5) [redacted]

From: "Dorr, Kaelan K. EOP/WHO" Kaelan Dorr, EOP [redacted]>
Date: Tuesday, September 19, 2017 at 3:28 PM
To: "Ferrier, Antonia (McConnell)" <Antonia_Ferrier@mcconnell.senate.gov>, Emily Schillinger <Emily.Schillinger@mail.house.gov>, "Buck, Brendan" <Brendan.Buck@mail.house.gov>
Cc: "Lawless, Julia (Finance)" <Julia_Lawless@finance.senate.gov>, Jessica Ditto Jessica Ditto, EOP [redacted]>, AshLee Strong <AshLee.Strong@mail.house.gov>, "Andres, Doug" <Doug.Andres@mail.house.gov>, "Popp, David (McConnell)" <David_Popp@mcconnell.senate.gov>, "Stewart, Don (McConnell)" <Don_Stewart@mcconnell.senate.gov>, "Sayegh, Tony E. EOP/WHO" Tony Sayegh, EOP [redacted]>, "Knight, Shahira E. EOP/WHO" Shahira Knight, EOP [redacted]>, "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov>
Subject: Big 6 Comms Meeting

All,

Tentative agenda for tomorrow's Communicators meeting is below. If you haven't already submitted your vitals please let me know ASAP.

Best,

Kaelan

b(5) [redacted]

RE: RELEASE: Corker, Toomey Statement on Tax Reform

From: "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>
To: "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Wed, 20 Sep 2017 09:09:38 -0400

You guys were a huge assist.

Brendan M. Dunn
Policy Advisor and Counsel
Office of the Senate Majority Leader

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Wednesday, September 20, 2017 4:52 AM
To: Daniel.Kowalski@treasury.gov; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Subject: Re: RELEASE: Corker, Toomey Statement on Tax Reform

Thanks. Nice work on this.

From: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Date: September 19, 2017 at 8:59:28 PM EDT
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>, Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: FW: RELEASE: Corker, Toomey Statement on Tax Reform

From: Johnson, Micah (Corker)
Sent: Tuesday, September 19, 2017 7:34 PM
To: Johnson, Micah (Corker) <Micah_Johnson@corker.senate.gov>
Subject: RELEASE: Corker, Toomey Statement on Tax Reform

UNITED STATES SENATE

For immediate release: September 19, 2017
Contacts:
Micah Johnson (Corker), 202-228-6523
Kasia Mulligan (Toomey), 202-224-8609

Corker, Toomey Statement on Tax Reform

WASHINGTON – U.S. Senators Bob Corker (R-Tenn.) and Pat Toomey (R-Pa.), members of the Senate Budget Committee, today announced a path forward on tax reform. The budget resolution would allow for a tax reduction, as scored on a static basis, over a 10-year period.

“I am strongly committed to pro-growth tax reform that will lead to more jobs and higher wages and was glad to work with Chairman Enzi and Senator Toomey at the request of Senate leadership to reach an agreement that will allow the committees of jurisdiction to begin their work to craft this important legislation,” **said Corker.** “While each member of the caucus will have to make their own decision, I believe our agreement gives the tax writing committees enough headroom to achieve real tax reform that eliminates loopholes and lowers tax rates for hardworking Americans. I will be watching closely as the tax reform legislation is drafted, and ultimately, my support will be contingent on a final package that generates significant economic growth and does not worsen but hopefully improves our fiscal situation.”

“I am confident the budget agreement I have reached with Chairman Enzi and Senator Corker will give the Finance Committee the headroom needed to write a pro-growth tax plan that reforms the code, causes the economy to surge, and ultimately results in reduced federal budget deficits,” **said Toomey.**

###

Possible Big 6 Document - DRAFT

From: "Knight, Shahira E. EOP/WHO" Shahira Knight, EOP [redacted]>

To: "Muzinich, Justin" <justin.muzinich@treasury.gov>, "(RYAN) Callas, George" <george.callas@mail.house.gov>, "Brendan M. Dunn (Brendan_Dunn@mcconnell.senate.gov)" <brendan_dunn@mcconnell.senate.gov>

Date: Wed, 20 Sep 2017 19:59:25 -0400

Attachments: Big 6 Framework Decision Items.docx (17.6 kB)

Took a stab at drafting this document. If anything is represented inaccurately, I promise it was unintentional. b(5) [redacted]
b(5) [redacted]

For 3:40 Call

From: "Knight, Shahira E. EOP/WHO" <[redacted]>

To: "Brendan M. Dunn (Brendan_Dunn@mcconnell.senate.gov)" <brendan_dunn@mcconnell.senate.gov>, "Muzinich, Justin" <justin.muzinich@treasury.gov>, "Callas, George" <george.callas@mail.house.gov>

Date: Thu, 21 Sep 2017 07:17:22 -0400

Attachments: Big 6 Call 9.21.2017.docx (17.05 kB)

This version [redacted]

Revised Framework

From:	"Knight, Shahira E. EOP/WHO" <Shahira Knight, EOP [redacted]>
To:	"Muzinich, Justin" <justin.muzinich@treasury.gov>, george.callas@mail.house.gov, "Brendan M. Dunn (Brendan_Dunn@mcconnell.senate.gov)" <brendan_dunn@mcconnell.senate.gov>
Date:	Thu, 21 Sep 2017 16:08:02 -0400
Attachments:	Big 6 Call 9.21.2017 Readout.docx (18.68 kB)

Please let me know if you disagree (based on today's call)

RE: Median family

From: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>
To: "Muzinich, Justin" <justin.muzinich@treasury.gov>, "Mackie, James III" <james.mackie@treasury.gov>
Cc: "Maloney, Drew" <drew.maloney@treasury.gov>, "Kowalski, Daniel" <daniel.kowalski@treasury.gov>, Shahira Knight, EOP [redacted] "Coughlan, Tony (Finance)" <tony_coughlan@finance.senate.gov>, "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>
Date: Thu, 21 Sep 2017 17:25:43 -0400
Attachments: b(5) [redacted] (20.22 kB)

Thanks for the call, Justin.

b(5) [redacted]

b(5) [redacted]

Tony Coughlan handles the CTC and family provisions. Jennifer assists on those issues, too. Tony prepared this memo. b(5) [redacted]
b(5) [redacted]

b(5) [redacted]

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Thursday, September 21, 2017 5:12 PM
To: James.Mackie@treasury.gov
Cc: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Drew.Maloney@treasury.gov; Daniel.Kowalski@treasury.gov; Shahira Knight, EOP [redacted]
Subject: Median family

Jay - b(5) [redacted]
b(5) [redacted]

Mark - b(5) [redacted]
b(5) [redacted]

RE: Median family

From: "Coughlan, Tony (Finance)" <tony_coughlan@finance.senate.gov>
To: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, "Muzinich, Justin" <justin.muzinich@treasury.gov>, "Mackie, James III" <james.mackie@treasury.gov>
Cc: "Maloney, Drew" <drew.maloney@treasury.gov>, "Kowalski, Daniel" <daniel.kowalski@treasury.gov>, Shahira Knight, EOP [redacted], "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>
Date: Thu, 21 Sep 2017 17:33:59 -0400
Attachments: b(5) [redacted]docx (20.24 kB)

Attached is a very slightly revised/improved version of the memo Mark just circulated.

From: Prater, Mark (Finance)
Sent: Thursday, September 21, 2017 5:26 PM
To: Justin.Muzinich@treasury.gov; James.Mackie@treasury.gov
Cc: Drew.Maloney@treasury.gov; Daniel.Kowalski@treasury.gov; Shahira Knight, EOP [redacted]; Coughlan, Tony (Finance) <Tony_Coughlan@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Median family

Thanks for the call, Justin.

b(5) [redacted]

b(5) [redacted]

Tony Coughlan handles the CTC and family provisions. Jennifer assists on those issues, too. Tony prepared this memo. b(5) [redacted]
b(5) [redacted]

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Thursday, September 21, 2017 5:12 PM
To: James.Mackie@treasury.gov
Cc: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Drew.Maloney@treasury.gov; Daniel.Kowalski@treasury.gov; Shahira Knight, EOP [redacted]
Subject: Median family

Jay - b(5) [redacted]
b(5) [redacted]

Mark - b(5) [redacted]
b(5) [redacted]

RE: Median family

From: "Coughlan, Tony (Finance)" <tony_coughlan@finance.senate.gov>
To: "Mackie, James III" <james.mackie@treasury.gov>
Date: Thu, 21 Sep 2017 18:03:42 -0400
Attachments: b(5) [redacted] docx (20.24 kB)

Hi, Jay –

Please use the attached examples. Example 4 is slightly different. b(5) [redacted]

Tony

From: James.Mackie@treasury.gov [mailto:James.Mackie@treasury.gov]
Sent: Thursday, September 21, 2017 6:02 PM
To: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Justin.Muzinich@treasury.gov
Cc: Drew.Maloney@treasury.gov; Daniel.Kowalski@treasury.gov; Shahira Knight, EOP [redacted]; Coughlan, Tony (Finance) <Tony_Coughlan@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Median family

We certainly can look at the case that Justin described.

b(5) [redacted]

We also will look at the examples that Tony has done.

From: Prater, Mark (Finance) [mailto:Mark_Prater@finance.senate.gov]
Sent: Thursday, September 21, 2017 5:26 PM
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>; Mackie, James III <James.Mackie@treasury.gov>
Cc: Maloney, Drew <Drew.Maloney@treasury.gov>; Kowalski, Daniel <Daniel.Kowalski@treasury.gov>; Shahira Knight, EOP [redacted]; Coughlan, Tony (Finance) <Tony_Coughlan@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Median family

Thanks for the call, Justin.

b(5) [redacted]

b(5) [redacted]

Tony Coughlan handles the CTC and family provisions. Jennifer assists on those issues, too. Tony prepared this memo. b(5) [redacted]

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]

Sent: Thursday, September 21, 2017 5:12 PM
To: James.Mackie@treasury.gov
Cc: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Drew.Maloney@treasury.gov; Daniel.Kowalski@treasury.gov; Shahira Knight, EOP [redacted]
Subject: Median family

Jay - b(5) [redacted]
b(5) [redacted]

Mark - b(5) [redacted]
b(5) [redacted]

Partnership reform/raisers

From: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>
To: "Trier, Dana" <dana.trier@treasury.gov>
Cc: "Hanna, Christopher (Finance)" <christopher_hanna@finance.senate.gov>
Date: Tue, 10 Oct 2017 11:10:18 -0400
Attachments: b(5) [redacted]

Hi Dana,

It was nice meeting with you last week, we very much appreciate your offer to make your team available. b(5) [redacted] b(5) Who better than a tax god to give them a look!? We know you are busy and appreciate any insight you can share on the attached.

Thank you!!!

Jen

Jen Acuña
Senior Tax Counsel & Policy Advisor
Senate Finance Committee
Tel: (202) 224-4515

Re: Partnership reform/raisers

From: "Trier, Dana" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3fb4cbf9d1c84bb08776ff0c42348329-trier, dana">

To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>

Date: Tue, 10 Oct 2017 11:12:47 -0400

Will get back as soon as possible! Dana

From: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Date: October 10, 2017 at 11:10:41 AM EDT
To: Trier, Dana <Dana.Trier@treasury.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Subject: Partnership reform/raisers

Hi Dana,

It was nice meeting with you last week, we very much appreciate your offer to make your team available. b(5) [redacted] b(5) [redacted] Who better than a tax god to give them a look!? We know you are busy and appreciate any insight you can share on the attached.

Thank you!!!

Jen

Jen Acuña
Senior Tax Counsel & Policy Advisor
Senate Finance Committee
Tel: (202) 224-4515

RE: Meeting request

From: [redacted]@treasury.gov>
To: "Gosnell, Ellen" <ellen.gosnell@mail.house.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>, "Horton, Brett" <brett.horton@mail.house.gov>, "Poling, Parker" <parker.poling@mail.house.gov>
Cc: "Shackelford, Lindsey" <lindsey.shackelford@mail.house.gov>, [redacted]@treasury.gov>
Date: Tue, 10 Oct 2017 16:35:55 -0400

Hi Ellen! The Secretary is running about 10 minutes behind for this meeting. I hope this will not be a problem. Thank you!

[redacted]

From: Gosnell, Ellen [mailto:Ellen.Gosnell@mail.house.gov]
Sent: Thursday, October 05, 2017 3:12 PM
To: [redacted]@treasury.gov>; Maloney, Drew <Drew.Maloney@treasury.gov>; Horton, Brett <Brett.Horton@mail.house.gov>; Poling, Parker <Parker.Poling@mail.house.gov>
Cc: Shackelford, Lindsey <lindsey.shackelford@mail.house.gov>; [redacted]@treasury.gov>
Subject: RE: Meeting request

Great! The meeting will be in Rep. Scalise's Whip Office, H-328 US Capitol Building. I have it confirmed on Rep. Scalise' s calendar. Please let me know if you have any questions.

Thank you,

Ellen Gosnell
Scheduler
House Majority Whip Steve Scalise
Mobile | (202) 641-5148

From: [redacted]@treasury.gov [mailto:[redacted]@treasury.gov]
Sent: Wednesday, October 04, 2017 5:00 PM
To: Gosnell, Ellen <Ellen.Gosnell@mail.house.gov>; Drew.Maloney@treasury.gov; Horton, Brett <Brett.Horton@mail.house.gov>; Poling, Parker <Parker.Poling@mail.house.gov>
Cc: Shackelford, Lindsey <lindsey.shackelford@mail.house.gov>; [redacted]@treasury.gov
Subject: RE: Meeting request

Hi Ellen! I would like to confirm that Tuesday, Oct. 10th at 5:00pm will work for Secretary Mnuchin. Please let me know where this meeting will be held. I will circle back shortly to let you know who will accompany the Secretary to this meeting. Thanks very much!

[redacted]

From: Gosnell, Ellen [mailto:Ellen.Gosnell@mail.house.gov]
Sent: Wednesday, October 04, 2017 4:11 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>; Horton, Brett <Brett.Horton@mail.house.gov>; Poling, Parker <Parker.Poling@mail.house.gov>
Cc: Shackelford, Lindsey <lindsey.shackelford@mail.house.gov>; [redacted]@treasury.gov>; [redacted]@treasury.gov>
Subject: RE: Meeting request

Hi Drew,

Please let us know if 5:00pm on Tuesday, October 10th works for the Secretary. If not, I will circle back with some other times that work for Whip Scalise and Chief Deputy Whip McHenry.

Thank you!

Ellen Gosnell
Scheduler
House Majority Whip Steve Scalise
Mobile | [redacted]

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Wednesday, October 04, 2017 2:15 PM
To: Horton, Brett <Brett.Horton@mail.house.gov>; Poling, Parker <Parker.Poling@mail.house.gov>
Cc: Shackelford, Lindsey <lindsey.shackelford@mail.house.gov>; Gosnell, Ellen <Ellen.Gosnell@mail.house.gov>; [redacted]@treasury.gov; [redacted]@treasury.gov
Subject: Meeting request

The Secretary would like to meet with the Whip and Deputy Whip next week if possible to discuss tax reform.

I have copied [redacted] who handles the Secretary's schedule.

Let me know if something works.

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: [redacted]
drew.maloney@treasury.gov

Materials from today's meeting with Treasury

To: jennifer_acuna@finance.senate.gov, christopher_hanna@finance.senate.gov, eric_oman@finance.senate.gov

Date: Thu, 12 Oct 2017 15:24:48 -0400

Attachments: [redacted] (32.72 kB); Recommendations on Tax Reform doc - SENATE DRAFT 10.11.17 blz.docx (60.64 kB); [redacted].docx (25.99 kB); [redacted] (3).docx (32.26 kB)

Hi all,

Attached are the materials that we distributed at today's meeting. If you have any questions regarding these, let us know. As we said at the meeting, if Treasury can provide further technical assistance in any way, we are happy to do so.

Best regards,
Doug

RE: tax reform

From: "Elliott, Joel (Donnelly)" <joel_elliott@donnelly.senate.gov>
To: [redacted]@treasury.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>
Cc: "Lattanner, Andrew (Donnelly)" <andrew_lattanner@donnelly.senate.gov>
Date: Mon, 16 Oct 2017 14:26:16 -0400

Thank you.

From: [redacted]@treasury.gov [mailto:[redacted]@treasury.gov]
Sent: Monday, October 16, 2017 2:26 PM
To: Elliott, Joel (Donnelly) <Joel_Elliott@donnelly.senate.gov>; Drew.Maloney@treasury.gov
Cc: Lattanner, Andrew (Donnelly) <Andrew_Lattanner@donnelly.senate.gov>
Subject: RE: tax reform

Great, thanks. Below is the dial-in info.

Dial-In: [redacted]
Passcode: [redacted]

From: Elliott, Joel (Donnelly) [mailto:Joel_Elliott@donnelly.senate.gov]
Sent: Monday, October 16, 2017 2:24 PM
To: [redacted]@treasury.gov>; Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: Lattanner, Andrew (Donnelly) <Andrew_Lattanner@donnelly.senate.gov>
Subject: RE: tax reform

It will work. Will you supply dial-in info?

From: [redacted]@treasury.gov]
Sent: Monday, October 16, 2017 2:19 PM
To: Elliott, Joel (Donnelly) <Joel_Elliott@donnelly.senate.gov>; Drew.Maloney@treasury.gov
Cc: Lattanner, Andrew (Donnelly) <Andrew_Lattanner@donnelly.senate.gov>
Subject: RE: tax reform

Hi Joel,

Would 10:45AM on Wednesday work for a call?

From: Elliott, Joel (Donnelly) [mailto:Joel_Elliott@donnelly.senate.gov]
Sent: Monday, October 16, 2017 2:17 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: [redacted]@treasury.gov>; Lattanner, Andrew (Donnelly) <Andrew_Lattanner@donnelly.senate.gov>
Subject: RE: tax reform

Drew, do you have any time on Wednesday morning?

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, October 16, 2017 1:29 PM
To: Elliott, Joel (Donnelly) <Joel_Elliott@donnelly.senate.gov>
Cc: [redacted]@treasury.gov
Subject: tax reform

Joel,

Let me know when it is convenient to catch up on tax reform.

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

RE: Technical assistance - Treasury contacts

From: "West, Thomas" <thomas.west@treasury.gov>
To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>
Cc: "Hanna, Christopher (Finance)" <christopher_hanna@finance.senate.gov>, "Trier, Dana" <dana.trier@treasury.gov>, b(6) [redacted] <b(6) [redacted]@treasury.gov>, "b(6) [redacted]@treasury.gov>, b(6) [redacted] b(6) [redacted]@treasury.gov>
Date: Mon, 16 Oct 2017 20:38:03 -0400
Attachments: b(5) [redacted]

Hi Jen,

I am attaching some documents to inform our discussion. b(5) [redacted]

Our schedules are packed this week and Friday is probably the best day for all of us, but if we need to do something sooner we can muster a contingent.

Best,
Tom

Tom West
(202) 622-6707
thomas.west@treasury.gov

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Friday, October 13, 2017 6:28 PM
To: West, Thomas
Cc: Hanna, Christopher (Finance)
Subject: RE: Technical assistance - Treasury contacts

Hi Tom,

Hope all is well! We would like to schedule a time next week for your team to brief us on b(5) [redacted] Let me know what works for you guys.

Have a great weekend! :)

Jen

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Wednesday, October 4, 2017 3:32 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; David.Kautter@treasury.gov; James.Mackie@treasury.gov; Dana.Trier@treasury.gov; Thomas.West@treasury.gov; Douglas.Poms@treasury.gov; LafayetteChip.Harter@treasury.gov; Robert.Neis@treasury.gov

Subject: Technical assistance - Treasury contacts

Jen,

As discussed, here are Office of Tax Policy staff to whom you should feel free to reach out to discuss technical drafting issues:

Passthroughs
Dana Trier (Deputy Assistant Secretary for Tax Policy), 622-0140, dana.trier@treasury.gov

International
Doug Poms, 622-1754, douglas.poms@treasury.gov

Individual
Tom West, 622-6707, thomas.west@treasury.gov

Estate, gift and basis at death
Austin Bramwell, 622-7827, austin.bramwell@treasury.gov

Corporate
Tom West, 622-6707, thomas.west@treasury.gov

We have working groups on each topic and are available to review drafts and meet at your convenience. Thanks.

Regards,
Austin

Austin Bramwell
Office of Tax Policy | U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW |Washington, D.C. 20220
202-622-7827 | austin.bramwell@treasury.gov

RE: Estate tax - leg specs

From: "Bramwell, Austin" <austin.bramwell@treasury.gov>

To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>, "Hanna, Christopher (Finance)" <christopher_hanna@finance.senate.gov>

Cc: b(6) [redacted]@treasury.gov>, b(6) [redacted] b(6) [redacted]@treasury.gov>, "Oman, Eric (Finance)" <eric_oman@finance.senate.gov>, "Kautter, David" <david.kautter@treasury.gov>

Date: Mon, 16 Oct 2017 21:46:31 -0400

Attachments: b(5) [redacted] b(5) [redacted] FY 2017 select budget proposals.pdf (171.11 kB); b(5) [redacted] b(5) [redacted]

Jen,

As promised, I am attaching the following:

- Memorandum on selected high-level issues with the proposed legislation;
- Line-by-line comments;
- A description of b(5) [redacted] b(5) [redacted] and
- b(5) [redacted]

Finally, by separate e-mail, we will also send a memorandum that discusses b(5) [redacted] b(5) [redacted]

We would be happy to discuss these materials or any questions or comments at your convenience.

Regards,
Austin

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Friday, October 13, 2017 5:58 PM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>; Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Cc: b(6) [redacted]@treasury.gov>; b(6) [redacted] <b(6) [redacted]@treasury.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: Estate tax - leg specs

Hi Austin,

Likewise! Thank you so much for trekking over here to meet with us. We are very excited to review the materials and reconnect in the upcoming week. Have a wonderful weekend!

Jen

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Thursday, October 12, 2017 10:42 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Cc b(6) [redacted]@treasury.gov; b(6) [redacted]@treasury.gov
Subject: RE: Estate tax - leg specs

Jen,

It was a pleasure to meet you in person yesterday. We should have our comments on the draft you sent us, a description of [redacted]

Austin

From: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Date: October 11, 2017 at 6:06:26 PM EDT
To: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>, Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: [redacted]@treasury.gov> [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

We have arrived and managed to find our way 211 already! See you soon.

From: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Date: October 11, 2017 at 6:01:51 PM EDT
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>, Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Cc: [redacted]@treasury.gov>, [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

Hi Austin, Please let me know when you guys arrive.

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Wednesday, October 11, 2017 1:00 PM
To: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: [redacted]@treasury.gov; [redacted]@treasury.gov
Subject: RE: Estate tax - leg specs

Great –see you then.

From: Hanna, Christopher (Finance) [mailto:Christopher_Hanna@finance.senate.gov]
Sent: Wednesday, October 11, 2017 12:36 PM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: [redacted]@treasury.gov>; [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

We can host -- 6pm today. We have reserved Senate Dirksen room 211. Thanks.

Sent from my Verizon, Samsung Galaxy smartphone

-------- Original message --------
From: Austin.Bramwell@treasury.gov
Date: 10/11/17 7:16 AM (GMT-06:00)
To: "Acuna, Jennifer (Finance)" <Jennifer_Acuna@finance.senate.gov>
Cc: [redacted]@treasury.gov[redacted]@treasury.gov, "Hanna, Christopher (Finance)" <Christopher_Hanna@finance.senate.gov>
Subject: RE: Estate tax - leg specs

Just following up on venue -- I think it would be most productive to meet in person, if you are willing to host us, but we defer to you.

From: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Date: October 10, 2017 at 12:31:36 PM EDT
To: 'Acuna, Jennifer (Finance)' <Jennifer_Acuna@finance.senate.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

6 tomorrow it is! Would you like to meet in person or speak by phone?

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Tuesday, October 10, 2017 12:27 PM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>; [redacted] <[redacted]@treasury.gov>; [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

Great! How about tomorrow at 6?

Looking forward to it! ☺

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Tuesday, October 10, 2017 12:26 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov> [redacted]@treasury.gov [redacted]@treasury.gov
Subject: RE: Estate tax - leg specs

Thank you, Jen. We look forward to working with you on this. I am copying my colleagues [redacted] and [redacted]

It looks as if we are free tomorrow afternoon (October 11) after 3:30, Thursday (October 12) from 10 to 11:30, and from 12 to 5. Please let us know if any of those times work for you. Thanks.

Best,
Austin

Austin Bramwell
Office of Tax Policy | U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW | Washington, D.C. 20220

202-622-7827 | austin.bramwell@treasury.gov

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Tuesday, October 10, 2017 11:52 AM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Subject: Estate tax - leg specs

Hi Austin,

As promised last week, attached please find one of our b(5) [redacted] b(5) [redacted] b(5) [redacted] Can we find a time to chat in the upcoming days to discuss?

Thanks!!

Jen

Jen Acuña
Senior Tax Counsel & Policy Advisor
Senate Finance Committee
Tel: (202) 224-4515

RE: Estate tax - leg specs

From: "Bramwell, Austin" <austin.bramwell@treasury.gov>
To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>, "Hanna, Christopher (Finance)" <christopher_hanna@finance.senate.gov>
Cc: [redacted]" <[redacted]@treasury.gov>, [redacted]" [redacted]@treasury.gov>, "Oman, Eric (Finance)" <eric_oman@finance.senate.gov>, "Kautter, David" <david.kautter@treasury.gov>
Date: Tue, 17 Oct 2017 12:53:16 -0400
Attachments: [redacted].docx (36.97 kB)

Jen – as promised, see attached our memorandum on [redacted]. If you'd like all 5 pieces of commentary in one e-mail just let me know.

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Monday, October 16, 2017 10:13 PM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>; Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Cc: Hughes, Catherine <Catherine.Hughes@treasury.gov>; Anantham, Siva <Siva.Anantham@treasury.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>; Kautter, David <David.Kautter@treasury.gov>
Subject: Re: Estate tax - leg specs

Thanks Austin! We will be in touch very soon to schedule a follow-up.

Sent from my Verizon, Samsung Galaxy smartphone

-------- Original message --------
From: Austin.Bramwell@treasury.gov
Date: 10/16/17 9:48 PM (GMT-05:00)
To: "Acuna, Jennifer (Finance)" <Jennifer_Acuna@finance.senate.gov>, "Hanna, Christopher (Finance)" <Christopher_Hanna@finance.senate.gov>
Cc: [redacted]@treasury.gov, [redacted]@treasury.gov, "Oman, Eric (Finance)" <Eric_Oman@finance.senate.gov>, David.Kautter@treasury.gov
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- Line-by-line comments;
- A description of [redacted] and
- [redacted]

Finally, by separate e-mail, we will also send a memorandum that discusses [redacted]

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Subject: RE: Estate tax - leg specs

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Date: October 11, 2017 at 6:06:26 PM EDT
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Cc: [redacted]@treasury.gov>, [redacted]@treasury.gov>
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Date: October 11, 2017 at 6:01:51 PM EDT
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Cc: [redacted]@treasury.gov>, [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

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Cc [redacted] @treasury.gov; [redacted] @treasury.gov
Subject: RE: Estate tax - leg specs

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Cc: [redacted] @treasury.gov>; [redacted] @treasury.gov>
Subject: RE: Estate tax - leg specs

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To: "Acuna, Jennifer (Finance)" <Jennifer_Acuna@finance.senate.gov>
Cc: [redacted] @treasury.gov, [redacted] @treasury.gov, "Hanna, Christopher (Finance)" <Christopher_Hanna@finance.senate.gov>
Subject: RE: Estate tax - leg specs

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Date: October 10, 2017 at 12:31:36 PM EDT
To: 'Acuna, Jennifer (Finance)' <Jennifer_Acuna@finance.senate.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>, [redacted] @treasury.gov>, [redacted] @treasury.gov>
Subject: RE: Estate tax - leg specs

6 tomorrow it is! Would you like to meet in person or speak by phone?

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Sent: Tuesday, October 10, 2017 12:27 PM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>; [redacted]

[redacted]@treasury.gov>; [redacted]@treasury.gov>
Subject: RE: Estate tax - leg specs

Great! How about tomorrow at 6?

Looking forward to it! ☺

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Tuesday, October 10, 2017 12:26 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>[redacted]@treasury.gov[redacted]@treasury.gov
Subject: RE: Estate tax - leg specs

Thank you, Jen. We look forward to working with you on this. I am copying my colleagues [redacted] and [redacted]

It looks as if we are free tomorrow afternoon (October 11) after 3:30, Thursday (October 12) from 10 to 11:30, and from 12 to 5. Please let us know if any of those times work for you. Thanks.

Best,
Austin

Austin Bramwell
Office of Tax Policy | U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW | Washington, D.C. 20220
202-622-7827 | austin.bramwell@treasury.gov

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Tuesday, October 10, 2017 11:52 AM
To: Bramwell, Austin <Austin.Bramwell@treasury.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>
Subject: Estate tax - leg specs

Hi Austin,

As promised last week, attached please find one of our [redacted] but wanted to get you and your team's thoughts on the attached. Can we find a time to chat in the upcoming days to discuss?

Thanks!!

Jen

Jen Acuña
Senior Tax Counsel & Policy Advisor
Senate Finance Committee
Tel: (202) 224-4515

RE: following up

From: "Trier, Dana" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3fb4cbf9d1c84bb08776ff0c42348329-trier, dana">

To: "Angus, Barbara" <barbara.angus@mail.house.gov>

Date: Wed, 18 Oct 2017 15:26:19 -0400

Barbara, Sorry for not getting back to you this morning. We had an hour long fire drill, and everything was downhill from there.

b(5)

[redacted]

b(5) [redacted] Happy to discuss later.

Dana

From: Angus, Barbara [mailto:Barbara.Angus@mail.house.gov]
Sent: Tuesday, October 17, 2017 12:56 PM
To: Trier, Dana <Dana.Trier@treasury.gov>
Subject: following up

Thanks very much for a good session today. I would like to follow up and talk further about interest. Can we find a time to do that in the next couple of days?

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
1136 Longworth House Office Building
202.225.5522
barbara.angus@mail.house.gov

RE:

From: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>
To: "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Thu, 19 Oct 2017 10:25:43 -0400
Attachments: b(5) [redacted] docx (14.56 kB)

Does this do it, Drew?

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Thursday, October 19, 2017 10:23 AM
To: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>
Subject:

b(5) [redacted]

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

October 5, 2018

Sara Kaiser Creighton
Elizabeth France
John E. Bies
American Oversight
1030 15th Street NW, Suite B255
Washington, DC 20005
foia@americanoversight.org

Re: *American Oversight v. U.S. Department of the Treasury*, 17-cv-2078-RBW (D.D.C.): Treasury September 5 Production

Counsel:

This letter describes the October 5, 2018 production from the U.S. Department of the Treasury (Treasury) in the above-referenced Freedom of Information Act litigation. Pursuant to the Court's February 2, 2018 Order, Treasury has reviewed and processed 60 documents collected in response to American Oversight's Congressional Communications FOIA Request, 2017-08-121. Via email, Treasury is producing 35 documents totaling 71 pages, comprising the non-exempt, responsive portions of the records within this collection. The documents are numbered UST 000909 - 979; portions of these materials are withheld pursuant to Exemptions 5 and 6 of the FOIA. An additional 20 documents, totaling 75 pages, are being withheld in their entirety pursuant to Exemption 5, and four documents are non-responsive and/or duplicative of other materials within this collection and are therefore not being produced.

Treasury is continuing to review records that are potentially responsive to this request and will respond to you again on or before November 5, 2018.

If you have any questions concerning this production or a related matter, please contact Rebecca Kopplin, U.S. Department of Justice, at (202) 514-3953.

Sincerely,

Ryan Law
Office of Privacy, Transparency, and Records
U.S. Department of the Treasury

RE: Technical assistance - Treasury contacts

From: "West, Thomas" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=westt">

To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>

Date: Thu, 19 Oct 2017 18:57:59 -0400

No problem

From: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Date: October 19, 2017 at 6:26:55 PM EDT
To: West, Thomas <Thomas.West@treasury.gov>
Subject: RE: Technical assistance - Treasury contacts

Hey Tom,

Tomorrow has turned into a fire drill for us, so we need to reschedule for the following week.

Thanks!!

Jen

From: Thomas.West@treasury.gov [mailto:Thomas.West@treasury.gov]
Sent: Wednesday, October 18, 2017 9:46 AM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Technical assistance - Treasury contacts

Hi Jen, Friday is starting to get booked with other things for some of us – how does noon -230 window look for you?

Tom West
(202) 622-6707
thomas.west@treasury.gov

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Tuesday, October 17, 2017 7:32 PM
To: West, Thomas
Cc: Hanna, Christopher (Finance); Trier, Dana; b(6) [redacted]
Subject: RE: Technical assistance - Treasury contacts

Hey Tom,

We just got a request from our leg counsel to move our drafting session to the 10am time slot. Any chance your team is available later in the afternoon?

Thanks!

Jen

From: Thomas.West@treasury.gov [mailto:Thomas.West@treasury.gov]
Sent: Monday, October 16, 2017 8:38 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>;
Dana.Trier@treasury.gov; b(6) [redacted]@treasury.gov; b(6) [redacted]@treasury.gov;

b(6) [redacted]@treasury.gov
Subject: RE: Technical assistance - Treasury contacts

Hi Jen,

I am attaching some documents to inform our discussion. b(5) [redacted]
b(5) [redacted]
b(5) [redacted]

Our schedules are packed this week and Friday is probably the best day for all of us, but if we need to do something sooner we can muster a contingent.

Best,
Tom

Tom West
(202) 622-6707
thomas.west@treasury.gov

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Friday, October 13, 2017 6:28 PM
To: West, Thomas
Cc: Hanna, Christopher (Finance)
Subject: RE: Technical assistance - Treasury contacts

Hi Tom,

Hope all is well! We would like to schedule a time next week for your team to brief us on previous Greenbook corporate raisers. Let me know what works for you guys.

Have a great weekend! :)

Jen

From: Austin.Bramwell@treasury.gov [mailto:Austin.Bramwell@treasury.gov]
Sent: Wednesday, October 4, 2017 3:32 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Cc: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; David.Kautter@treasury.gov; b(6) [redacted]@treasury.gov; Dana.Trier@treasury.gov; Thomas.West@treasury.gov; Douglas.Poms@treasury.gov; LafayetteChip.Harter@treasury.gov; Robert.Neis@treasury.gov
Subject: Technical assistance - Treasury contacts

Jen,

As discussed, here are Office of Tax Policy staff to whom you should feel free to reach out to discuss technical drafting issues:

> Passthroughs
> Dana Trier (Deputy Assistant Secretary for Tax Policy), 622-0140, dana.trier@treasury.gov
>
> International
> Doug Poms, 622-1754, douglas.poms@treasury.gov
>
> Individual
> Tom West, 622-6707, thomas.west@treasury.gov

Estate, gift and basis at death
Austin Bramwell, 622-7827, austin.bramwell@treasury.gov

Corporate
Tom West, 622-6707, thomas.west@treasury.gov

We have working groups on each topic and are available to review drafts and meet at your convenience. Thanks.

Regards,
Austin

Austin Bramwell
Office of Tax Policy | U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW |Washington, D.C. 20220
202-622-7827 | austin.bramwell@treasury.gov

RE: TA Request on Confidential Draft Language

From:	"Bailey, Bradley" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=7eb678b02d9b41c0af365038a082c58e-bailey, bradl">
To:	"Portman, Stuart (Finance)" <stuart_portman@finance.senate.gov>
Cc:	"Bonelli, Anna (Finance)" <anna_bonelli@finance.senate.gov>, "Kuskowski, Jennifer (Finance)" <jennifer_kuskowski@finance.senate.gov>
Date:	Thu, 19 Oct 2017 23:32:22 -0400
Attachments:	101717 TAM17J23_XML confidential draft (Treasury).doc (39.42 kB)

Stuart,

Please see attached comments. One note: we would normally coordinate comments with HHS but have not done so here. Please consider these as Treasury TA only.

Brad

From: Portman, Stuart (Finance) [mailto:Stuart_Portman@finance.senate.gov]
Sent: Tuesday, October 17, 2017 2:37 PM
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>
Cc: Bonelli, Anna (Finance) <Anna_Bonelli@finance.senate.gov>; Kuskowski, Jennifer (Finance) <Jennifer_Kuskowski@finance.senate.gov>
Subject: TA Request on Confidential Draft Language

Hi Brad,

I hope all is well. After our briefing with Senate Finance Committee LAs, the ideas we heard in the room were synthesized into the attached discussion draft. As such, we request that Treasury provide TA as quickly as possible on this language. Please keep this draft language confidential, and reach out if you have any questions; I am happy to answer to the best of my ability. My direct is 202.224.6918. Thank you!

--
Stuart Portman
Health Policy Advisor
U.S. Senate Committee on Finance

Re: Saw this in Politico Huddle

From: "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>

To: "Muzinich, Justin" <justin.muzinich@treasury.gov>

Cc: george.callas@mail.house.gov, "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, Shahira Knight, EOP [redacted], barbara.angus@mail.house.gov

Date: Fri, 20 Oct 2017 08:24:20 -0400

Thanks Justin.
And it wasn't even that late a night!

Sent from my iPhone

On Oct 20, 2017, at 7:07 AM, "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov> wrote:

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 17, 2017 at 11:31:06 AM EDT
To: Shahira Knight, EOP [redacted] <Shahira Knight, EOP [redacted]>, Muzinich, Justin <Justin.Muzinich@treasury.gov>, Mark_Prater@finance.senate.gov <Mark_Prater@finance.senate.gov>
Cc: Angus, Barbara <Barbara.Angus@mail.house.gov>, Brendan_Dunn@mcconnell.senate.gov <Brendan_Dunn@mcconnell.senate.gov>
Subject: RE: Saw this in Politico Huddle

b(5) [redacted]

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Tuesday, October 17, 2017 10:17 AM
To: Mark_Prater@finance.senate.gov; Shahira Knight, EOP [redacted]
Cc: Callas, George; Angus, Barbara; Brendan_Dunn@mcconnell.senate.gov
Subject: Re: Saw this in Politico Huddle

Thanks Mark

From: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>
Date: October 17, 2017 at 10:10:22 AM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]>
Cc: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>, Barbara.Angus@Mail.House.Gov Barbara.Angus@Mail.House.Gov <Barbara.Angus@Mail.House.Gov>, Callas, George <George.Callas@mail.house.gov>
Subject: Saw this in Politico Huddle

FYI

Sent from my Verizon, Samsung Galaxy smartphone

Sent from my Verizon, Samsung Galaxy smartphone

FOR PLANNING PURPOSES
October 16, 2017

Contact: Rachel McCleery (202) 224-4515

*****MEDIA ADVISORY*****

ON BACKGROUND: Pass-through Loophole 101: Senate Finance Committee Democratic Policy Staff Break Down New Tax Dodge for Wealthy Americans

WASHINGTON – Senate Finance Committee Senior Democratic Policy Staff will lead a press call on **TUESDAY, October 17**, to explain the new pass-through rate in Trump's tax scam. Staff will detail what pass-through status is, why wealthy individuals, not the middle class, will benefit from the proposed rate, and how this new loophole will choke off funding for Social Security and Medicare. The entire call will be on background attributable to Senate Democratic aides.

Who: **Senate Finance Committee Senior Democratic Staff**

What: **Press conference call**

When: **October 17, 2017**
3:00 PM EST

*****For call in information, please RSVP to Emily Zahnle-Hostetler at Emily_zahnle-hostetler@wyden.senate.gov, with your name, outlet, and phone number*****

Treasury comments/proposals: RR 91-32 and subpart F

From:	"Poms, Douglas" <douglas.poms@treasury.gov>
To:	jennifer_acuna@finance.senate.gov
Cc:	christopher_hanna@finance.senate.gov, "Trier, Dana" <dana.trier@treasury.gov>, "Harter, Chip" <lafayettechip.harter@treasury.gov>, b(6) [redacted] @treasury.gov>, b(6) [redacted] @treasury.gov>, b(6) [redacted] b(6) [redacted] @treasury.gov>
Date:	Fri, 20 Oct 2017 19:56:10 -0400
Attachments:	Treasury comments on proposal to modify section 864 in relation to Rev Rul 91-32.docx (29.11 kB); Subpart F Tax Reform Memo (10-20-2017).docx (43.74 kB)

Hi Jen,

I hope you survived the week. Attached are (i) our comments on the draft language for RR 91-32 fix and (ii) the complete list of our proposed legislative fixes to subpart F (we had sent the first of these subpart F proposals last Friday). If you would like to discuss any of these, just let us know.

Have a great weekend and hopefully get some rest,
Doug

RE: Proposed legislative fixes to subpart F provisions

From: "Poms, Douglas" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=pomsd">
To: '[redacted]@jct.gov>
Cc: '[redacted]@treasury.gov>, "Harter, Chip" <lafayettechip.harter@treasury.gov>, '[redacted]@treasury.gov>
Date: Sun, 22 Oct 2017 12:24:31 -0400

Great. Thank you, [redacted]

Doug

From: [redacted]@JCT.gov>
Date: October 22, 2017 at 11:51:10 AM EDT
To: Poms, Douglas <Douglas.Poms@treasury.gov>
Cc: [redacted]@treasury.gov>, [redacted]@treasury.gov>, Harter, Chip <LafayetteChip.Harter@treasury.gov>
Subject: RE: Proposed legislative fixes to subpart F provisions

Thanks for emailing these proposals, Doug.

We have circulated them within our staff and to the Republican staff of the Ways and Means committee.

David

From: Douglas.Poms@treasury.gov [mailto:Douglas.Poms@treasury.gov]
Sent: Friday, October 20, 2017 3:56 PM
To: [redacted]@JCT.gov>
Cc: LafayetteChip.Harter@treasury.gov; [redacted]@treasury.gov; [redacted]@treasury.gov
Subject: Proposed legislative fixes to subpart F provisions

Hi [redacted]

Attached are some proposed legislative fixes to the subpart F provisions that could be considered as part of tax reform. If you can circulate to your staff, as appropriate, and W&M staff, we would appreciate it.

Thanks and have a great weekend,
Doug

RE: Passthrough Rate

From: "Trier, Dana" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3fb4cbf9d1c84bb08776ff0c42348329-trier, dana">
To: "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>
Date: Mon, 23 Oct 2017 10:36:48 -0400

b(5) b(5) [redacted] DLT

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Monday, October 23, 2017 10:34 AM
To: Trier, Dana <Dana.Trier@treasury.gov>
Subject: RE: Passthrough Rate

Hi Dana,

b(5) b(5) [redacted] Looking forward to catching up soon.

Jen

From: Dana.Trier@treasury.gov [mailto:Dana.Trier@treasury.gov]
Sent: Monday, October 23, 2017 10:01 AM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Passthrough Rate

Hi, I am chatting with Dave about b(5) [redacted] again at 11:30. We did discuss your ideas last week, and even had brief conversations with Justin M. If you wanted to apprise me of something before 11:30 that you want a specific reaction to, happy to talk. Dana

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Friday, October 20, 2017 3:08 PM
To: Trier, Dana <Dana.Trier@treasury.gov>
Subject: RE: Passthrough Rate

b(5) [redacted]

From: Dana.Trier@treasury.gov [mailto:Dana.Trier@treasury.gov]
Sent: Friday, October 20, 2017 3:07 PM
To: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: RE: Passthrough Rate

Jennifer,
b(5) [redacted] think misunderstood.

From: Acuna, Jennifer (Finance) [mailto:Jennifer_Acuna@finance.senate.gov]
Sent: Friday, October 20, 2017 1:49 PM
To: Trier, Dana <Dana.Trier@treasury.gov>
Cc: Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Coughlan, Tony (Finance) <Tony_Coughlan@finance.senate.gov>; Hanna, Christopher (Finance) <Christopher_Hanna@finance.senate.gov>; Monie, Alex (Finance) <Alex_Monie@finance.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>; Pippins, Martin (Finance) <Martin_Pippins@finance.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Rutledge, Preston (Finance) <Preston_Rutledge@finance.senate.gov>; Wrase, Jeff (Finance)

<Jeff_Wrase@finance.senate.gov>; Wyatt, Nick (Finance) <Nick_Wyatt@finance.senate.gov>
Subject: Passthrough Rate

Hi Dana,

Sorry we had to reschedule our discussion on b(5) [redacted] to next week. Given the time crunch, can we touch base on b(5) [redacted] in the upcoming days? Does your team have time to either meet or hop on a call?

Thanks!!

Jen

Jen Acuña
Senior Tax Counsel & Policy Advisor
Senate Finance Committee
Tel: (202) 224-4515

FW: Materials from today's meeting with Treasury

From: "Poms, Douglas" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=pomsd">

To: jennifer_acuna@finance.senate.gov

Date: Mon, 23 Oct 2017 13:21:36 -0400

Attachments: Considerations on SFC staff inbound proposal for expanding 163j principl....docx (32.72 kB); Recommendations on Tax Reform doc - SENATE DRAFT 10.11.17 blz.docx (60.64 kB); Transfer Pricing - Leg Proposal Limited Record DRAFT (BTO) SdAL.(BTO 10-12).docx (25.99 kB); Baseball arbitration Statutory Language DRAFT (clean 10-11) (SdAL) (3).docx (32.26 kB); LH for 936 and 482 proposals.doc (64 kB); Subpart F Tax Reform Memo (10-20-2017).docx (43.74 kB); Treasury comments on proposal to modify section 864 in relation to Rev Rul 91-32.docx (29.11 kB)

Hi Jen, here is everything we sent. Let us know if you have any questions as well as when you would like to discuss the administrative record proposal (and anything else you might want to discuss).

Doug

Rough Outline of Thoughts for Estimate

From: [redacted]@treasury.gov>
To: "Dowd, Tim" <tim.dowd@mail.house.gov>, [redacted]@jct.gov>
Cc: [redacted]@treasury.gov>, [redacted] <[redacted]@treasury.gov>
Date: Mon, 23 Oct 2017 17:28:01 -0400
Attachments: Portman Toomey Inbound_np v2.docx (22.25 kB)

Hi Tim/[redacted]

For what it is worth, here is an initial (rough) outline of our understanding of the general specifications of, and a possible (rough) methodology for estimating, the Oosterhuis "inbound" proposal. [redacted]

[redacted]

FW: Passthrough Rate Activity Examples

From:	"Trier, Dana" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3fb4cbf9d1c84bb08776ff0c42348329-trier, dana">
To:	"Angus, Barbara" <barbara.angus@mail.house.gov>
Date:	Tue, 24 Oct 2017 12:02:30 -0400
Attachments:	Passthrough Rate Activity Examples 10-24-17.docx (16.31 kB)

Barbara,

Attached as we agreed are examples of b(5) [redacted] Hope you are surviving.

Dana

[redacted]

From: "Kautter, David" <david.kautter@treasury.gov>
To: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>
Cc: "[redacted]@treasury.gov>
Date: Tue, 24 Oct 2017 17:29:39 -0400
Attachments: [redacted]

Mark

We promised you a few tables over a week ago and I am just getting them to you. Sorry

As you look at this, [redacted]

If you have any questions, please let [redacted] know [redacted]

Thanks

Dave

Re: Tax Reform

From: "Specht, Brittan" <brittan.specht@mail.house.gov>
To: "Knight, Shahira E. EOP/WHO" Shahira Knight, EOP [redacted]>
Cc: "Callas, George" <george.callas@mail.house.gov>, "Reiser, Martin" <martin.reiser@mail.house.gov>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Thu, 26 Oct 2017 22:40:55 -0400

Thanks for organizing.

Brittan G. Specht, CFA
Majority Leader Kevin McCarthy

On Oct 26, 2017, at 10:34 PM, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]> wrote:

Holding it. We will get a conf call number. Thanks.

On Oct 26, 2017, at 9:37 PM, Callas, George <George.Callas@mail.house.gov> wrote:

> 1045 is the current bid.
>
> On Oct 26, 2017, at 9:33 PM, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]> wrote:
>
>> Justin and I can make either work.
>>
>> On Oct 26, 2017, at 9:27 PM, Callas, George <George.Callas@mail.house.gov> wrote:
>>
>>> How about 930 or 1045?
>>>
>>> On Oct 26, 2017, at 8:59 PM, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]> wrote:
>>>
>>> Hi all,
>>>
>>> b(5) [redacted]
>>>
>>> b(5) b(5) [redacted] Can we please set up a call for the five of us tomorrow to discuss? I will propose 10 AM but please let me know if that doesn't work.

Thanks,

Shahira

tax reform catch-up call (Leadership/NEC/Treasury)

Where:	[redacted]
When:	Fri Oct 27 10:45:00 2017 (America/New_York)
Until:	Fri Oct 27 11:15:00 2017 (America/New_York)
Organiser:	"Knight, Shahira E. EOP/WHO" [redacted]>
Required Attendees:	"Muzinich, Justin" <justin.muzinich@treasury.gov> "Specht, Brittan (Brittan.Specht@mail.house.gov)" <brittan.specht@mail.house.gov> martin.reiser@mail.house.gov "Callas, George" <george.callas@mail.house.gov>

Dial in: [redacted]
Participant's Passcode: [redacted]

RE: Phone call

From: "Maloney, Drew" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=0aa00d7c98de43f9aec8f68a919f6fe3-maloney, drew">

To: "Rielly, Billy (Toomey)" <billy_rielly@toomey.senate.gov>

Date: Fri, 27 Oct 2017 11:18:32 -0400

Tax reform and thanks for leadership on budget

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

From: Rielly, Billy (Toomey) <Billy_Rielly@toomey.senate.gov>
Date: October 27, 2017 at 11:04:05 AM EDT
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: RE: Phone call

Drew,

What does the Secretary want to discuss with the Senator?

Thanks,

Billy

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Friday, October 27, 2017 10:33 AM
To: Rielly, Billy (Toomey) <Billy_Rielly@toomey.senate.gov>
Cc: Brandt, Daniel (Toomey) <Daniel_Brandt@toomey.senate.gov>; Herndon, Randy (Toomey) <Randy_Herndon@toomey.senate.gov>; Patricia.Griffin@treasury.gov
Subject: RE: Phone call

11:30a works, what is best number for the Secretary to call

From: Rielly, Billy (Toomey) [mailto:Billy_Rielly@toomey.senate.gov]
Sent: Friday, October 27, 2017 9:06 AM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: RE: Phone call

Drew,

The Senator has availability today from 11-noon and then 3-4:30.

Best,

Billy

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]

Sent: Friday, October 27, 2017 8:15 AM
To: Brandt, Daniel (Toomey) <Daniel_Brandt@toomey.senate.gov>
Cc: Herndon, Randy (Toomey) <Randy_Herndon@toomey.senate.gov>; Malloy, Maxwell (Toomey) <Maxwell_Malloy@toomey.senate.gov>; Patricia.Griffin@treasury.gov; Rielly, Billy (Toomey) <Billy_Rielly@toomey.senate.gov>
Subject: Re: Phone call

15 mins

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

From: Brandt, Daniel (Toomey) <Daniel_Brandt@toomey.senate.gov>
Date: October 27, 2017 at 8:12:10 AM EDT
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: Malloy, Maxwell (Toomey) <Maxwell_Malloy@toomey.senate.gov>, Herndon, Randy (Toomey) <Randy_Herndon@toomey.senate.gov>, Griffin, Pat <Patricia.Griffin@treasury.gov>, Rielly, Billy (Toomey) <Billy_Rielly@toomey.senate.gov>
Subject: Re: Phone call

Danielle is out on maternity leave. I have CC'd our scheduling Team.

For situational awareness, PT is traveling in the state promoting tax reform and has a packed day.

There may be some times in the car we could schedule some time but I defer to Billy.

How much time you thinking?

Sent from my iPhone

On Oct 27, 2017, at 8:07 AM, "Drew.Maloney@treasury.gov" <Drew.Maloney@treasury.gov> wrote:

> Danielle,
>
> The Secretary is traveling in the middle east today, but would like to touch base with the Senator this morning. Is there time available to arrange a call?
>
> Thanks
>
> Drew
>
> *Drew Maloney*
> *Assistant Secretary of the Treasury*
> *Legislative Affairs*
> *United States Department of the Treasury*
> *1500 Pennsylvania Avenue, NW Suite 3134*
> *Washington, DC 20220*

Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

Child Tax Credit & Free Speech Fairness Act

From: "Neill, Jim (Budget)" <jim_neill@budget.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Fri, 27 Oct 2017 11:39:25 -0400
Attachments: FRC 1 Pager CTC and Unborn Child 10.23.17.doc (290.82 kB); FSFA issue brief.doc (118.27 kB)

Hi Dan – hope you're well.

I wanted to provide two documents that were given to me by David Christensen with the Family Research Council (FRC). One covers the Child Tax Credit (CTC) & the other is the 'Johnson Amendment' (FSFA).

Regarding FSFA and how Congress may take up, David told me that a paring back of FSFA – which is sponsored by Steve Scalise in the House -- to cover only churches and omits the inclusion of charities and their leaders would be something FRC President Tony Perkins "could not support."

Happy to chat if you'd like – otherwise, hope we see each other soon!

Jim Neill
U.S. Senate Budget Committee
SD-624
202/224-2370

ADVANCING FAITH, FAMILY AND FREEDOM

Improving the Child Tax Credit in FY18 Tax Reform Reconciliation

- The child tax credit (CTC) is available to mostly low-income individuals. It is currently as much as $1,000 per child, reduces income tax liability, is partially refundable, and includes marriage penalties for some families.

- The FY18 tax reform reconciliation bill should strengthen and expand the CTC by:
  - recognizing an *unborn child* within the CTC's statutory definition of a *qualifying child;*
  - increasing the CTC to at least $2,500 to $5,000; and
  - removing the CTC's marriage penalties.

- Allowing unborn children to qualify for the CTC in statute would be a significant pro-life achievement by recognizing the personhood of the unborn child in federal law. It would also help families cover the start-up costs associated with caring for a newborn.

- Federal law already recognizes the "unborn child" in a few areas of law
  - The *Unborn Victims of Violence Act of 2004* (18 USC 1841):
    - *the term "unborn child" means a child in utero, and the term "child in utero" or "child, who is in utero" means a member of the species homo sapiens, at any stage of development, who is carried in the womb.*
  - The Child Health Insurance Program's 2002 Unborn Child Rule (42 CFR 457.10):
    - *Child means an individual under the age of 19 including the period from conception to birth.*

- The Trump Campaign proposed a package of tax benefits for families like the "Child Care Credit" in 2016 to expand the ability of working parents, or parents who also stay at home, to obtain a credit. The proposal also included a proposal for Dependent Care Savings Accounts (https://www.frcaction.org/get.cfm?i=WA16I07&f=WU16I03). This proposal would have allowed dependents to include children and unborn children so that parents could begin cover the costs of preparing for their child. The child care credit and dependent care proposals have been wrapped into the Child Tax Credit in the Unified Framework for Fixing our Broken Tax Code. Therefore, the Child Tax Credit should include unborn children.

- Parents should be allowed to carry forward the CTC for their unborn child to the following taxable year, but only *after* the child is born and receives a taxable identification number. This approach would address verification concerns, since a parent could only retroactively claim the CTC for an unborn child after the child is born.

- In current law, the CTC contains a marriage penalty that should be removed by increasing the CTC phase-out threshold for married couples filing jointly to be at least double that of single filers. The CTC begins to phase out when adjusted gross income exceeds $75,000 for single filers, but for married couples filing jointly, the threshold is $110,000, which is less than double

The Free Speech Fairness Act:
Restoring First Amendment Speech Rights to Churches, Charities, and their Leaders

What is the Johnson Amendment?

The Johnson Amendment is a tax provision that prevents 501(c)(3) organizations from participating in political campaigns on behalf of, or in opposition to, a candidate for public office. The Johnson Amendment is an unconstitutional restraint on free speech, and is a tool the IRS uses to threaten and censor the First Amendment free speech rights of churches, charities, and their leaders. The Johnson Amendment was passed in 1954 and since then, has caused great confusion and concern regarding what tax-exempt organizations and their leaders may say about moral issues and political candidates.

Despite the IRS not revoking a church's tax-exempt status, organizations like Americans United for Separation of Church and State use the Johnson Amendment as a tool for threatening churches into self-censoring regarding political issues. During election seasons, these organizations send churches letters threatening to report the churches to the IRS if they make certain types of statements about political candidates, in the hopes that these churches would be silenced on political issues from fear of an IRS investigation or audit.

How does the Free Speech Fairness Act ("Fairness Act") roll back the Johnson Amendment?

For the past decade, thousands of pastors have spoken on political matters on Pulpit Freedom Sunday, with the goal being to elicit a court challenge and thus overturn the Johnson Amendment. The IRS has not directly responded to these sermons, so the strategy must be legislative.

The Fairness Act would restore free speech to churches, charities, and their leaders who, since the Johnson Amendment's passage, have effectively been silenced because of their charitable nature. The Fairness Act amends the Johnson Amendment to allow for political activity that is 1) made in the ordinary course of the 501(c)(3) organization's regular and customary activities, so long as the activities carry out the organization's tax-exempt purpose, and 2) so long as the organization does not incur more than *de minimis* incremental costs.

Should the Fairness Act apply to all non-profit organizations, or just churches?

The Fairness Act should apply to all non-profits, not just churches or pastors. While churches need protections, other 501(c)(3) organizations also need speech protections, as it is impractical to parse protections for churches and their integrated auxiliaries and conventions, from other non-profits. In addition, it is inequitable, and perhaps even unconstitutional, to allow churches and their integrated

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October 2016
Issue Brief IF16J01

auxiliaries to engage in some political campaign activities without also allowing other religious ministries and secular charities that are 501(c)(3) organizations to engage in such activities.

Wouldn't the Fairness Act eliminate the need for 501(c)(4) organizations and PACs?

The Fairness Act does not allow 501(c)(3) organizations to purchase political campaign advertisements or to become political action committees. In addition, the Fairness Act does not allow donations to be earmarked for political purposes. Taxpayers will still only be able to deduct from their taxes contributions to charitable, tax exempt organizations. The idea behind the Fairness Act is not to allow 501(c)(3) organizations to take the place of 501(c)(4) organizations or political action committees, nor would that be its effect.

Would the Fairness Act be constitutional?

Based on the limited jurisprudence governing this issue, the Fairness Act would more closely align the law governing 501(c)(3) organizations with the Constitution. Only a few cases have been litigated regarding an organization's tax-exempt status being lost because of engagement in political campaign activity. In one case, the IRS withdrew the tax-exempt letter of a church, Church at Pierce Creek, because it purchased full page newspaper ads urging Christians not to vote for Bill Clinton.[1] The withdrawal of the letter was upheld by the D.C. Court of Appeals.[2] However, because churches are not required to apply to the IRS for tax-exempt status, there is significant question about the implications of the court's decision on the tax-exempt status of churches. In addition, the Church at Pierce Creek's activity would not be protected by the Fairness Act. The Fairness Act provides for speech in the ordinary course of the 501(c)(3)'s ordinary and customary activities, which further the tax-exempt purpose of the organization, and do not exceed more than a *de minimis* incremental cost (the cost of the politically-related communication must be trivial).

That said, in the context of lobbying requirements on 501(c)(3) organizations, courts have held that Congress may impose some limits on the organization's First Amendment activity in exchange for a government subsidy. For example, in *Regan v. Taxation with Representation,* the Supreme Court defined tax exemptions and deductions as forms of subsidies and held that Congress "has the authority to determine whether the advantage the public would receive from additional lobbying by charities is worth the money the public would pay to subsidize that lobbying."[3] Thus, *Regan* underscores the fact that Congress retains the authority to restore the free speech rights of 501(c)(3) organizations, to free them up to speak about political candidates.

Why should the Free Speech Fairness Act be in the FY2018 Reconciliation Bill?

The Fairness Act addresses provisions in the IRS code; therefore, it makes sense to add this bill to the FY2018 reconciliation bill which will address tax reform. While the Fairness Act does not allow 501(c)(3) organizations to function like 501(c)(4) organizations or PACs, some estimate that donors will shift their taxable contributions from 501(c)(4) organizations or PACs to 501(c)(3) organizations. To the extent that taxable contributions shift to tax-exempt contributions the government will lose revenues, which in turn means the Fairness Act will trigger a budget score on the tax reform bill. This brings the provision in line with the Byrd rule budgetary requirements governing reconciliation. Therefore, the Fairness Act should be able to pass Congress on reconciliation with only 51 votes.

[1] *Branch Ministries v. Rossotti,* 211 F.3d 137, 140 (D.C. Cir. 2000).

[2] Ibid, 145.

[3] *Regan v. Taxation with Representation,* 461 U.S. 540, 544, 550 (1983).

Treasury comments on 10-25-17 W&M draft

To: [redacted]@JCT.gov)" [redacted]@jct.gov>, [redacted]@JCT.gov)" [redacted]@jct.gov>

Cc: "Harter, Chip" <lafayettechip.harter@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>

Date: Fri, 27 Oct 2017 16:12:20 -0400

Attachments: Recommendations on 10.25.17 version of House draft legislation -- 10.27.2017.docx (52.72 kB)

Hi [redacted] and [redacted]

Hope you all are holding up alright ☺ Attached are some Treasury comments on the 10-25-17 discussion draft of the House bill. Can you circulate to your staff, as appropriate, and share with W&M. We really appreciate it.

Also, if you all and/or W&M have any questions about our comments (or any other issues) and would like to discuss over the weekend, just let us know. We could set up a call or meet with you, whatever is most helpful.

Thanks and have a nice weekend,
Doug

Senator Scott's Investing In Opportunity Act

From:	"Wyatt, Nick (Finance)" <nick_wyatt@finance.senate.gov>
To:	"West, Thomas" <thomas.west@treasury.gov>, "Bailey, Bradley" <bradley.bailey@treasury.gov>
Cc:	"Hawkins, Shay (Scott)" <shay_hawkins@scott.senate.gov>, "Lavery, Emily (Scott)" <emily_lavery@scott.senate.gov>
Date:	Fri, 27 Oct 2017 16:35:28 -0400
Attachments:	S.293, Investing In Opportunity BILLS-115s293is.pdf (289.26 kB); The Investing in Opportunity Act Factsheet.pdf (317.94 kB)

Brad and Thomas,
We're working with Senator Scotts office to prep a proposal he's been working on for tax reform, and we've been working with JCT, and have some items that Treasury's input would be helpful in resolving.

The legislation, which is attached with a summary, allows individuals to defer capital gains if they invest in "Opportunity Zones" which are keyed off of New Markets Tax Credits depressed census tracts as designated by a governor.

b(5) [redacted]

b(5) [redacted]

Thank you for your help, Shay and Emily from Senator Scott's office are on this e-mail to answer any questions,
Nick

II

115TH CONGRESS
1ST SESSION

S. 293

To amend the Internal Revenue Code of 1986 to provide for the deferral of inclusion in gross income for capital gains reinvested in opportunity zones.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 2, 2017

Mr. SCOTT (for himself, Mr. BOOKER, Mr. BLUNT, Mr. BENNET, Mr. GRAHAM, Mr. COONS, Mrs. CAPITO, Mrs. GILLIBRAND, Mr. PETERS, Mr. GARDNER, Mr. YOUNG, and Mr. WARNER) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1986 to provide for the deferral of inclusion in gross income for capital gains reinvested in opportunity zones.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Investing in Opportunity Act".

SEC. 2. OPPORTUNITY ZONES.

(a) IN GENERAL.—Chapter 1 of the Internal Revenue Code of 1986 is amended by adding at the end the following:

"Subchapter Z—Opportunity Zones

"SEC. 1400Z–1. DESIGNATION.

"(a) QUALIFIED OPPORTUNITY ZONE DEFINED.—For the purposes of this subchapter, the term 'qualified opportunity zone' means a population census tract that is a low-income community that is designated as a qualified opportunity zone.

"(b) DESIGNATION.—

"(1) GOVERNOR.—

"(A) IN GENERAL.—For purposes of subsection (a), a population census tract that is a low-income community is designated as a qualified opportunity zone if—

"(i) not later than the end of the determination period, the governor of the State in which the tract is located—

"(I) nominates the tract for designation as a qualified opportunity zone, and

"(II) notifies the Secretary in writing of such nomination, and

"(ii) the Secretary certifies such nomination and designates such tract as a

qualified opportunity zone before the end of the consideration period.

"(B) EXTENSION OF PERIODS.—A governor may request that the Secretary extend either the determination or consideration period, or both (determined without regard to this subparagraph), for an additional 30 days.

"(C) DEEMED DESIGNATION IF SECRETARY FAILS TO ACT.—Unless the tracts are ineligible for designation, if the Secretary declines in writing to make such certification and designation or fails to act before the end of the consideration period, such nomination shall be deemed to be certified and designated, effective on the day after the last day of the consideration period.

"(2) SECRETARY.—If a governor fails to make the nominations and notifications by the end of the periods referred to in paragraphs (1)(A) and (1)(B), the Secretary shall designate and certify population census tracts that are low-income communities as qualified opportunity zones, as permitted by subsection (e).

"(c) OTHER DEFINITIONS.—For purposes of this subsection—

"(1) LOW-INCOME COMMUNITIES.—The term 'low-income community' has the same meaning as when used in section 45D(e).

"(2) DEFINITION OF PERIODS.—

"(A) CONSIDERATION PERIOD.—The term 'consideration period' means the 30-day period beginning on the date on which the Secretary receives notice under subsection (b)(1)(A)(i)(II), as extended under subsection (b)(1)(B).

"(B) DETERMINATION PERIOD.—The term 'determination period' means the 90-day period beginning on the date of the enactment of the Investing in Opportunity Act, as extended under subsection (b)(1)(B).

"(d) GUIDANCE FOR OPPORTUNITY ZONE NOMINATIONS.—When considering the nomination of qualified opportunity zones, governors should strive for the creation of qualified opportunity zones that are geographically concentrated and contiguous clusters of population census tracts and should give particular consideration to areas that—

"(1) are currently the focus of mutually reinforcing State, local, or private economic development

initiatives to attract investment and foster startup activity,

"(2) have demonstrated success in geographically targeted development programs, such as promise zones, new market tax credit, empowerment zones, and renewal communities, and

"(3) have recently experienced significant layoffs due to business closures or relocations.

"(e) NUMBER OF DESIGNATIONS.—

"(1) IN GENERAL.—Except as provided by paragraph (2), the number of population census tracts in a State that may be designated as qualified opportunity zones under this section may not exceed 25 percent of the number of low-income communities in the State.

"(2) EXCEPTION.—If the number of low-income communities in a State is less than 100, then a total of 25 of such tracts may be designated as qualified opportunity zones.

"(f) DESIGNATION OF TRACTS CONTIGUOUS WITH LOW-INCOME COMMUNITIES.—

"(1) IN GENERAL.—A population census tract that is not a low-income community may be designated as a qualified opportunity zone under this section if—

"(A) the tract is contiguous with the low-income community that is designated as a qualified opportunity zone, and

"(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tract is contiguous.

"(2) LIMITATION.—Not more than 5 percent of the population census tracts designated in a State as a qualified opportunity zone may be designated under paragraph (1).

"(g) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—A designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation.

"SEC. 1400Z–2. DEFERRAL FOR CAPITAL GAINS INVESTED IN OPPORTUNITY ZONES.

"(a) SPECIAL RULES WHEN GAIN FROM SALE OF PROPERTY INVESTED IN OPPORTUNITY ZONE PROPERTY.—

"(1) EXCLUSION OF GAIN INVESTED IN OPPORTUNITY ZONE PROPERTY.—In the case of gain from the sale to, or exchange with, an unrelated person of

any property held by the taxpayer, at the election of the taxpayer—

"(A) gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate cost of all qualified opportunity zone property acquired by the taxpayer during the 180-day period beginning on the date of such sale or exchange, and

"(B) the amount of gain excluded by subparagraph (A) shall be included in gross income as provided by paragraph (2).

"(2) DEFERRAL OF GAIN INVESTED IN OPPORTUNITY ZONE PROPERTY.—

"(A) YEAR OF INCLUSION.—Except as provided by subparagraph (C), gain to which paragraph (1)(B) applies shall be included in income in the taxable year in which the qualified opportunity zone property related to such gain is sold or exchanged in the amount determined under subparagraph (B).

"(B) AMOUNT INCLUDIBLE.—The amount of gain determined under this clause shall be—

"(i) 100 percent of such gain in the case of the sale or exchange of the qualified opportunity zone property with respect

to which gain is deferred under paragraph (1) that is held for less than 5 years,

"(ii) 90 percent of such gain in the case of the sale or exchange of the qualified opportunity zone property with respect to which gain is deferred under paragraph (1) that is held for at least 5 years but less than 7 years, and

"(iii) 85 percent of such gain in the case of the sale or exchange of the qualified opportunity zone property with respect to which gain is deferred under paragraph (1) that is held for at least 7 years.

"(C) PROPERTY HELD AFTER 2026 TREATED AS SOLD.—For purposes of subparagraph (A), any qualified opportunity zone property that has not been sold or exchanged on or before December 31, 2026, shall be treated as sold on December 31, 2026.

"(3) EXCLUSION OF GAIN ON QUALIFIED OPPORTUNITY ZONE PROPERTY HELD FOR AT LEAST 10 YEARS.—Except as provided in paragraph (2), in the case of the sale or exchange of qualified opportunity zone property, or an investment in a qualified opportunity fund, held for at least 10 years, gross income

for the taxable year shall not include any gain from the sale or exchange of such property or investment.

"(4) ONE ELECTION PER PROPERTY.—No election may be made under paragraph (1) with respect to a sale or exchange if an election previously made with respect to such sale or exchange is in effect.

"(b) BASIS RULES RELATING TO QUALIFIED OPPORTUNITY ZONE PROPERTY.—

"(1) REDUCED BY GAIN DEFERRED UNDER SUBSECTION (a)(1).—The basis of a qualified opportunity zone property immediately after its acquisition under subsection (a) shall be reduced by the amount of gain deferred by reason of subsection (a)(1)(A) with respect to such property.

"(2) INCREASE FOR GAIN RECOGNIZED UNDER SUBSECTION (a)(2).—The basis of qualified opportunity zone property shall be increased by the amount of gain recognized by reason of subsection (a)(2) with respect to such property.

"(3) SUBSEQUENT INCREASE IN BASIS FOR PROPERTY HELD FOR AT LEAST 5 YEARS BUT LESS THAN 10 YEARS.—In the case of qualified opportunity zone property held for at least 5 years but less than 10 years—

"(A) PROPERTY HELD FOR 5 YEARS.—For qualified opportunity zone property held for at least 5 years, the basis of such property shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A) with respect to such property.

"(B) PROPERTY HELD FOR 7 YEARS.—For qualified opportunity zone property held for at least 7 years, the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A) with respect to such property.

"(c) QUALIFIED OPPORTUNITY ZONE PROPERTY.—For purposes of this section:

"(1) IN GENERAL.—The term 'qualified opportunity zone property' means property which is—

"(A) qualified opportunity zone stock,

"(B) qualified opportunity zone partnership interest,

"(C) qualified opportunity zone business property, or

"(D) an interest in a qualified investment fund.

"(2) QUALIFIED OPPORTUNITY ZONE STOCK.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified opportunity zone stock' means any stock in a domestic corporation if—

"(i) such stock is acquired by the taxpayer after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

"(ii) as of the time such stock was issued, such corporation was a qualified opportunity zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a qualified opportunity zone business), and

"(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a qualified opportunity zone business.

"(B) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

"(3) QUALIFIED OPPORTUNITY ZONE PARTNERSHIP INTEREST.—The term 'qualified opportunity

zone partnership interest' means any capital or profits interest in a domestic partnership if—

"(A) such interest is acquired by the taxpayer after December 31, 2017, from the partnership solely in exchange for cash,

"(B) as of the time such interest was acquired, such partnership was a qualified opportunity zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a qualified opportunity zone business), and

"(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a qualified opportunity zone business.

"(4) QUALIFIED OPPORTUNITY ZONE BUSINESS PROPERTY.—

"(A) IN GENERAL.—The term 'qualified opportunity zone business property' means tangible property used in a trade or business of the taxpayer if—

"(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2017,

"(ii) the original use of such property in the qualified opportunity zone commences with the taxpayer or the taxpayer substantially improves the property, and

"(iii) during substantially all of the taxpayer's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

"(B) SUBSTANTIAL IMPROVEMENT.—For purposes of subparagraph (A)(ii), property shall be treated as substantially improved by the taxpayer only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the taxpayer exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the taxpayer.

"(C) RELATED PARTY.—For purposes of subparagraph (A)(i), the related person rule of section 179(d)(2) shall be applied pursuant to paragraph (8) of this subsection in lieu of the application of such rule in section 179(d)(2)(A).

"(5) QUALIFIED OPPORTUNITY FUND.—The term 'qualified opportunity fund' means any investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined—

"(A) on the last day of the first 6-month period of the taxable year of the fund, and

"(B) on the last day of the taxable year of the fund.

"(6) QUALIFIED OPPORTUNITY ZONE BUSINESS.—

"(A) IN GENERAL.—The term 'qualified opportunity zone business' means a trade or business—

"(i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property,

"(ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b), and

"(iii) which is not described in section 144(c)(6)(B).

"(B) SPECIAL RULE.—For purposes of subparagraph (A), tangible property that ceases to be a qualified opportunity zone business property shall continue to be treated as a qualified opportunity zone business property for the lesser of—

"(i) 5 years after the date on which such tangible property ceases to be so qualified, or

"(ii) the date on which such tangible property is no longer held by the qualified opportunity zone business.

"(d) APPLICABLE RULES.—

"(1) IN GENERAL.—For purposes of this section and except as otherwise provided in this section, rules similar to the rules applicable to deferred like kind exchanges under section 1031 shall apply except that reinvestment in opportunity zone property need not require an intermediary party.

"(2) RELATED PERSONS.—For purposes of this subsection, persons are related to each other if such persons are described in section 267(b) or 707(b)(1),

determined by substituting '20 percent' for '50 percent' each place it occurs in such sections.

"(3) DECEDENTS.—In the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.

"(4) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(A) rules providing for proportionate inclusion in income and increases in basis for purposes of subsections (a) and (b) in cases in which a sale or exchange of any qualified opportunity zone property with respect to which gain is deferred under subsection (a)(1)(A) is less than all of such property,

"(B) rules requiring taxpayers to provide such information as the Secretary determines to be necessary or appropriate for the identification of both the assets sold (including basis and sale price) and the assets acquired and investments made, and

"(C) rules to prevent abuse.

"(e) FAILURE OF QUALIFIED OPPORTUNITY FUND TO MAINTAIN INVESTMENT STANDARD.—

"(1) IN GENERAL.—If a qualified opportunity fund fails to meet the 90-percent requirement of subsection (c)(5), the qualified opportunity fund shall pay a penalty for each month it fails to meet the requirement in an amount equal to the product of—

"(A) the excess of—

"(i) the amount equal to 90 percent of its aggregate assets, over

"(ii) the aggregate amount of qualified opportunity zone property held by the fund, multiplied by

"(B) the underpayment rate established under section 6621(a)(2) for such month.

"(2) SPECIAL RULE FOR PARTNERSHIPS.—In the case that the qualified opportunity fund is a partnership, the penalty imposed by paragraph (1) shall be taken into account proportionately as part of the distributive share of each partner of the partnership.

"(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with

respect to any failure if it is shown that such failure is due to reasonable cause.''.

(b) BASIS ADJUSTMENTS.—Section 1016(a) of such Code is amended by striking ''and'' at the end of paragraph (36), by striking the period at the end of paragraph (37) and inserting '', and'', and by inserting after paragraph (37) the following:

''(38) to the extent provided in section 1400Z–2(b).''.

(c) REPORT TO CONGRESS.—The Secretary of the Treasury, or the Secretary's delegate, shall submit a report to Congress on the opportunity zone incentives enacted by this section beginning 5 years after the date of enactment of this Act and annually thereafter. The report shall include an assessment of investments held by qualified opportunity funds nationally and at the State level. To the extent such information is available, the report shall include the number of qualified opportunity funds, the amount of assets held in qualified opportunity funds, the composition of qualified opportunity fund investments by asset class, the percentage of qualified opportunity zone census tracts designated under subchapter Z of the Internal Revenue Code of 1986 (as added by this section) that have received qualified opportunity fund investments. The report shall also include an assessment of the impacts and

outcomes of the investments in those areas on economic indicators including job creation, poverty reduction, and new business starts, and other metrics as determined by the Secretary.

(d) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 of such Code is amended by adding at the end the following new item:

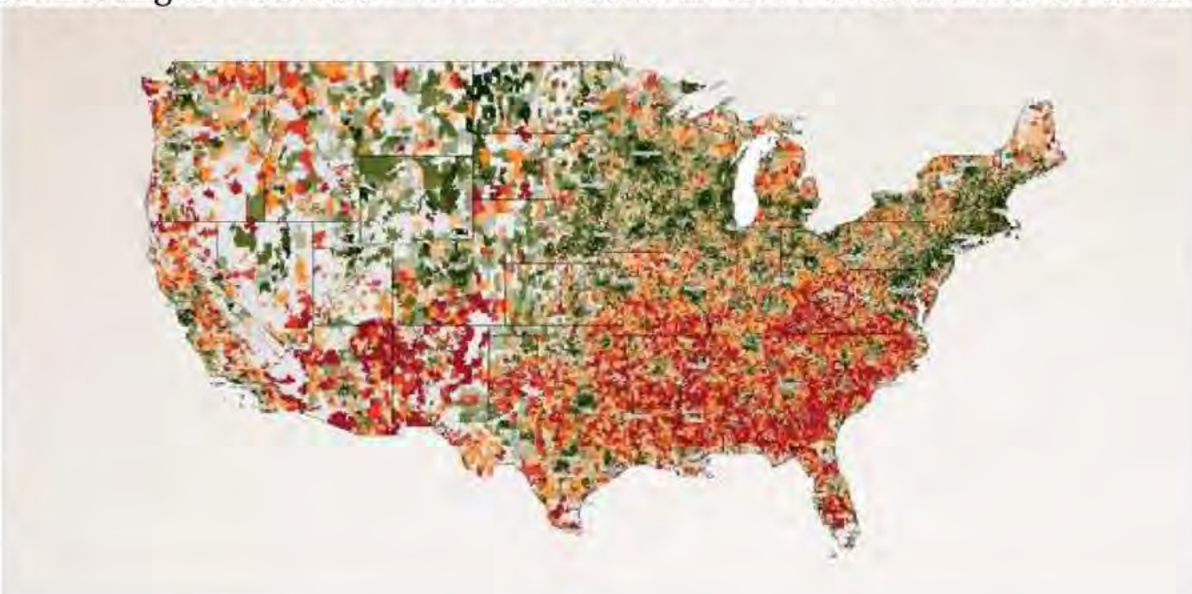
"SUBCHAPTER Z. OPPORTUNITY ZONES".

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

○

The Investing in Opportunity Act Factsheet

Senators **Tim Scott (R-SC)** and **Cory Booker (D-NJ)** and Congressmen **Pat Tiberi (R-OH)** and **Ron Kind (D-WI)** introduced the *Investing in Opportunity Act* to help revitalize economically distressed communities which suffer from a lack of investment and business growth, by facilitating new incentives for investment in those areas around the country.



Today, more than 50 million Americans live in a distressed community, and American investors have trillions of dollars of inactive capital that, if reinvested, could be an important new source for catalyzing growth and opportunity. These new dollars could help stem the tide of business closures, a lack of access to capital, and absent entrepreneurship in areas that need it most.

The *Investing in Opportunity Act* encourages new investment by:

- **Allowing investors to temporarily defer capital gains recognition if they reinvest into an "Opportunity Zone."** U.S. investors currently hold an estimated $2.3 trillion in unrealized capital gains—a significant untapped resource for economic development. This legislation allows investors to temporarily defer capital gains recognition

from the sale of an appreciated asset, but *only* if they reinvest the gains into qualified assets in an Opportunity Zone. This will remove the tax disincentive for investors to roll assets into distressed communities, and preserve a larger amount of capital for investment in distressed communities.

- **Encouraging investors to pool resources and risk in "Opportunity Funds" (O Funds).** Many investors are willing to provide the capital, but lack the wherewithal to locate and execute investment opportunities in communities that need it. These new O Funds will democratize economic development by allowing a broad array of investors throughout the country to pool resources and mitigate risk, increasing the scale of investments going to underserved areas and thereby increasing the probability of neighborhood turnaround. O Funds would be required to invest 90 percent of their resources in qualifying Opportunity Zones.

- **Giving governors the responsibility for designating Opportunity Zones.** This legislation uses the New Markets Tax Credit (NMTC) program definition of a "low income community" as the basis for defining areas eligible to be designated an Opportunity Zone. Governors will be able to designate no more than 25 percent of the total number of qualifying NMTC census tracts and all areas will have to meet the required threshold of economic distress. This approach will help ensure local needs and opportunities are being met as well as encourage concentration of capital in targeted, geographically contiguous zones in each state.

The legislation is designed to be **low cost and low risk** to the taxpayer. Investors bear the risk and are on the hook for all of their originally deferred capital gains, minus a modest reduction for long-term holdings, regardless whether subsequent investments have increased or decreased in value. There are no tax credits and no public sector financing is involved.

Finally, this legislation **incentivizes long-term investment** via a modest reduction in capital gains taxes owed on the original investment after holding qualified investments for five to seven years. Patient capital is further rewarded by exempting qualified investments held for more than 10 years from additional capital gains recognition beyond that which was originally deferred.

Fwd: capped itemized deductions

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">
To: George Callas <george.callas@mail.house.gov>
Cc: Shahira E. Knight Shahira Knight, EOP [redacted]>
Date: Fri, 27 Oct 2017 18:24:28 -0400
Attachments: Current Law Rough Score 2017_10_27.xlsx (13.87 kB)

George - As discussed. b(5) [redacted] and we are happy to work on variations of the theme if helpful.

From: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Date: October 27, 2017 at 9:56:46 AM EDT
To: 'Angus, Barbara' <Barbara.Angus@mail.house.gov>
Cc: 'Knight, Shahira E. EOP/WHO' Shahira Knight, EOP [redacted]>
Subject: capped itemized deductions

Barbara – Thanks for chatting just now. As discussed, all of our resources are available to help. b(5) [redacted]

b(5) [redacted] Let's chat again this afternoon if helpful.

Justin

RE: capped itemized deductions

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">

To: "Callas, George" <george.callas@mail.house.gov>

Date: Fri, 27 Oct 2017 18:38:20 -0400

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 27, 2017 at 6:30:58 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: RE: capped itemized deductions

Thanks. b(5) [redacted]

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Friday, October 27, 2017 6:24 PM
To: Callas, George
Cc: S [redacted]
Subject: Fwd: capped itemized deductions

George - As discussed, b(5) [redacted], and we are happy to work on variations of the theme if helpful.

From: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Date: October 27, 2017 at 9:56:46 AM EDT
To: 'Angus, Barbara' <Barbara.Angus@mail.house.gov>
Cc: 'Knight, Shahira E. EOP/WHO' Shahira Knight, EOP [redacted]>
Subject: capped itemized deductions

Barbara – Thanks for chatting just now. As discussed, all of our resources are available to help. b(5) [redacted] b(5) [redacted] Let's chat again this afternoon if helpful.

Justin

Re: Available to meet tomorrow afterno on?

From: "Huang, Gerald (Perdue)" <gerald_huang@perdue.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Fri, 27 Oct 2017 20:36:07 -0400

Russell 455

Sent from my Verizon, Samsung Galaxy smartphone

-------- Original message --------
From: Daniel.Kowalski@treasury.gov
Date: 10/27/17 6:03 PM (GMT-06:00)
To: "Huang, Gerald (Perdue)" <Gerald_Huang@perdue.senate.gov>
Subject: RE: Available to meet tomorrow afterno on?

Great. I'll meet you at your office and we can go from there. What room #?

From: Huang, Gerald (Perdue) [mailto:Gerald_Huang@perdue.senate.gov]
Sent: Friday, October 27, 2017 6:55 PM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: Re: Available to meet tomorrow afterno on?

Works for me

Sent from my Verizon, Samsung Galaxy smartphone

-------- Original message --------
From: Daniel.Kowalski@treasury.gov
Date: 10/27/17 5:26 PM (GMT-06:00)
To: "Huang, Gerald (Perdue)" <Gerald_Huang@perdue.senate.gov>
Subject: RE: Available to meet tomorrow afterno on?

How about Tuesday? I will be over there for an 11:30 meeting, so could meet with you at 12:30 or later. We can meet for lunch if that works for you.

From: Huang, Gerald (Perdue) [mailto:Gerald_Huang@perdue.senate.gov]
Sent: Thursday, October 26, 2017 8:04 AM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: RE: Available to meet tomorrow afterno on?

Dan,

Let me know when you are free to meet next week, I am happy to meet at my office or come over to the Treasury, whatever works best for you.

Gerald

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Wednesday, October 25, 2017 9:33 PM

To: Huang, Gerald (Perdue) <Gerald_Huang@perdue.senate.gov>
Cc: Waldrop, PJ (Perdue) <PJ_Waldrop@perdue.senate.gov>
Subject: RE: Available to meet tomorrow afterno on?

Thanks Gerald. You are very kind. I know budget well, and I definitely missed being there for floor action last week, but this is a good change for me.

b(5) [redacted]

Let me see what I can find out and we can meet next week (I would not be able to email distribution info).

PJ, if you are around tomorrow, I'd still be interested in catching up with you.

From: Huang, Gerald (Perdue) <Gerald_Huang@perdue.senate.gov>
Date: October 25, 2017 at 9:13:50 PM EDT
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Cc: Waldrop, PJ (Perdue) <PJ_Waldrop@perdue.senate.gov>
Subject: RE: Available to meet tomorrow afterno on?

Dan,

Hope you are doing well at Treasury, Budget doesn't feel the same without you. Unfortunately, I am leaving town midday tomorrow. If PJ can't meet with you, I am happy to talk to you over the phone or meet next week. Here's a few things that we are working on:

1. b(5) [redacted]
2. [redacted]
3. [redacted]

There's a longer list but these were the first ones that popped up. Happy to keep talking.

Thanks,

Gerald

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Wednesday, October 25, 2017 8:04 PM
To: Huang, Gerald (Perdue) <Gerald_Huang@perdue.senate.gov>; Waldrop, PJ (Perdue) <PJ_Waldrop@perdue.senate.gov>
Subject: Available to meet tomorrow afterno on?

I know from the campaign Senator Perdue's interest in tax reform. Now that it looks like the process of legislating in earnest is going to begin, I'd be interested in talking with you to get your take on how the Senator feels that effort is proceeding, and what we here at Treasury should be doing.

I'll be meeting a former Budget colleague for lunch tomorrow, and am wondering if one or both of you might be available for a meeting tomorrow afternoon, after 1 pm.

Would you be available?

Thanks,
Dan Kowalski
Counselor to the Secretary
Department of the Treasury
202-622-0992 (desk, direct)

Distribution table

From:	"Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">
To:	George Callas <george.callas@mail.house.gov>, Barbara M. Angus <barbara.angus@mail.house.gov>
Cc:	Shahira E. Knight Shahira Knight, EOP [redacted]>
Date:	Fri, 27 Oct 2017 20:48:52 -0400
Attachments:	b(5) [redacted](revised 10272017) (003).pdf (53.25 kB)

Close hold. b(5) [redacted]
b(5) [redacted]

###

Score

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">

To: George Callas <george.callas@mail.house.gov>, Barbara M. Angus <barbara.angus@mail.house.gov>

Cc: Shahira E. Knight Shahira Knight, EOP [redacted]>

Date: Fri, 27 Oct 2017 21:07:57 -0400

Attachments: Tax reform v10.3 Plan B summary individual only.pdf (109.4 kB)

b(5) [redacted]

b(5) [redacted] Happy to discuss if helpful.

RE: Treasury comments on 10-25-17 W&M draft

To: [redacted]@jct.gov>, "Trier, Dana" <dana.trier@treasury.gov>
Cc: [redacted]@jct.gov>, "Harter, Chip" <lafayettechip.harter@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>, "[redacted]@treasury.gov>, [redacted]@treasury.gov>, "[redacted]@treasury.gov>
Date: Sat, 28 Oct 2017 15:59:08 -0400
Attachments: Recommendations on 10.27.17 version of House draft legislation -- 10.28.2017.docx (52.99 kB)

Hi [redacted]

We completely understand. As there has been a new draft dated 10-27 for which there was no time for our comments from yesterday to be considered, we are re-sending those same comments with the page and line numbers updated to reflect the changes to the document resulting from [redacted] We would appreciate if you could also share this updated version with W&M.

As always, please let us know if you have any questions or if we can help in any way.

Thanks,
Doug

From: [redacted]@JCT.gov]
Sent: Friday, October 27, 2017 4:32 PM
To: Poms, Douglas
Cc: [redacted] Harter, Chip; [redacted]
Subject: Re: Treasury comments on 10-25-17 W&M draft

Thanks Doug and colleagues.

We'll do our best to spend time on your comments.

[redacted]

On Oct 27, 2017, at 4:18 PM, "Douglas.Poms@treasury.gov" <Douglas.Poms@treasury.gov> wrote:

> Hi [redacted] and [redacted]
>
> Hope you all are holding up alright ☺ Attached are some Treasury comments on the 10-25-17 discussion draft of the House bill. Can you circulate to your staff, as appropriate, and share with W&M. We really appreciate it.
>
> Also, if you all and/or W&M have any questions about our comments (or any other issues) and would like to discuss over the weekend, just let us know. We could set up a call or meet with you, whatever is most helpful.
>
> Thanks and have a nice weekend,
> Doug

<Recommendations on 10.25.17 version of House draft legislation -- 10.27.2017.docx>

Re: Score

From: "Callas, George" <george.callas@mail.house.gov>
To: "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Sun, 29 Oct 2017 19:39:13 -0400

Thanks. You've got the wheels in my head turning.

On Oct 29, 2017, at 7:38 PM, "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov> wrote:

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 29, 2017 at 7:36:32 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: Re: Score

b(5) [redacted]

On Oct 29, 2017, at 7:24 PM, "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov> wrote:

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 29, 2017 at 7:12:39 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: Re: Score

b(5) [redacted]

From: Justin Muzinich <Justin.Muzinich@treasury.gov>
Date: Sunday, October 29, 2017 at 7:09 PM
To: "Callas, George" <George.Callas@mail.house.gov>
Subject: Re: Score

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 29, 2017 at 7:00:05 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: Re: Score

b(5) [redacted]

From: Justin Muzinich <Justin.Muzinich@treasury.gov>
Date: Sunday, October 29, 2017 at 6:19 PM
To: "Callas, George" <George.Callas@mail.house.gov>
Subject: Re: Score

b(5) [redacted]

From: Callas, George <George.Callas@mail.house.gov>
Date: October 29, 2017 at 6:07:33 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: Re: Score

b(5) [redacted]

From: Justin Muzinich <Justin.Muzinich@treasury.gov>
Date: Friday, October 27, 2017 at 9:08 PM
To: "Callas, George" <George.Callas@mail.house.gov>, "Angus, Barbara" <Barbara.Angus@mail.house.gov>
Cc: Shahira Knight, EOP [redacted]" <Shahira Knight, EOP [redacted]>
Subject: Score

b(5) [redacted]
b(5) [redacted]. Happy to discuss if helpful.

Re: Thank you

From: "Lee, Jane (McConnell)" <jane_lee@mcconnell.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Mon, 30 Oct 2017 05:37:30 -0400

Yes let me know! That's a good idea.

Sent from my iPhone

On Oct 29, 2017, at 9:32 PM, "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov> wrote:

Maybe later in the week b(5) [redacted] b(5) [redacted] I'll be spending some time there, so should be easier to meet up.

Dan

From: Lee, Jane (McConnell) [mailto:Jane_Lee@mcconnell.senate.gov]
Sent: Saturday, October 28, 2017 7:11 PM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: Re: Thank you

Hey! Yeah we're all trucking along. I could do 5:30? Otherwise in meetings. Would be good to see you! Let me know.
Hope you have time to enjoy the weekend.

Sent from my iPhone

On Oct 28, 2017, at 9:44 AM, "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov> wrote:

> You're very kind Jane, since I should be the one thanking you. We saved a lot of time not needing to conference on budget.
>
> b(5) [redacted]
>
> b(5) [redacted]
>
> I'm coming up for a couple of meetings on Tuesday. Available for coffee after 2:00?
>
> ---
>
> **From:** Lee, Jane (McConnell) <Jane_Lee@mcconnell.senate.gov>
> **Date:** October 28, 2017 at 9:35:51 AM EDT
> **To:** Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
> **Subject:** Thank you

Hey Dan, The adoption of the budget already seems like ages ago but wanted to thank you for all your guidance and help through the process. We miss you!
Already working on the next stage. The next few months will be fun.
Talk soon! - Jane

Sent from my iPhone

RE: Treasury Department Responses

From: [redacted]@treasury.gov>
To: jay_khosla@finance.senate.gov, "Stegmaier, Jason (Finance)" <jason_stegmaier@finance.senate.gov>
Cc: "Bailey, Bradley" <bradley.bailey@treasury.gov>, [redacted]@treasury.gov>, LegAffairs <legaffairs@treasury.gov>
Date: Tue, 31 Oct 2017 09:27:19 -0400
Attachments: Treasury on Tax Reform_McCaskill.pdf (209.55 kB)

Jay and Jason,

An additional letter from the Treasury Department on tax reform that Chairman Hatch was copied on is attached.

Thank you!

[redacted]

From: [redacted]
Sent: Tuesday, October 31, 2017 9:08 AM
To: 'jay_khosla@finance.senate.gov' <jay_khosla@finance.senate.gov>; 'Stegmaier, Jason (Finance)' <Jason_Stegmaier@finance.senate.gov>
Cc: Bailey, Bradley <Bradley.Bailey@treasury.gov>; [redacted]@treasury.gov>; LegAffairs <LegAffairs@treasury.gov>
Subject: Treasury Department Responses

Enclosed is a response from the Treasury Department to Senator Baldwin that Senator Hatch was copied on.

If you have any questions, please contact Brad Bailey at 202.622.1900.

Thanks,
[redacted]

[redacted]
Office of Legislative Affairs
Department of the Treasury
[redacted] (Office)
(Cell)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 31, 2017

The Honorable Claire McCaskill
United States Senate
Washington, DC 20510

Dear Senator McCaskill:

Thank you for your letter regarding the tax reform process. We share your goal of comprehensive tax reform with real results, and welcome your desire to be partners in the tax reform process. The Unified Framework for Tax Reform released on September 17, 2017, sets forth the proposals embraced by the Administration and members of the tax-writing committees. It is now up to those committees to work out details and develop legislation in a process that, as the Framework states, will be transparent and inclusive. We look forward to work with you in order to achieve historic tax reform.

Thank you again for your letter. If you have additional questions, please contact Bradley Bailey, Office of Legislative Affairs, at (202) 622-1900.

Sincerely,

Drew Maloney
Assistant Secretary for Legislative Affairs

Identical letter sent to:
The Honorable Ron Wyden
The Honorable Debbie Stabenow
The Honorable Maria Cantwell
The Honorable Bill Nelson
The Honorable Robert Menendez
The Honorable Thomas R. Carper
The Honorable Benjamin L. Cardin
The Honorable Sherrod Brown
The Honorable Michael F. Bennet
The Honorable Robert P. Casey, Jr.
The Honorable Mark R. Warner

cc: Mr. Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Mitch McConnell

RE: catch up call today

From: "Youngen, Angie (Portman)" <angie_youngen@portman.senate.gov>
To: [redacted]@treasury.gov>
Cc: "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Tue, 31 Oct 2017 12:18:24 -0400

Certainly understand. Would 6:00 tonight work or is the evening out?

From: [redacted]@treasury.gov [mailto:[redacted]@treasury.gov]
Sent: Tuesday, October 31, 2017 12:16 PM
To: Youngen, Angie (Portman) <Angie_Youngen@portman.senate.gov>
Cc: Drew.Maloney@treasury.gov
Subject: RE: catch up call today

Hi Angie! As it turns out the Secretary cannot make 5:30 today work. While it is not urgent to do this call today, does the Senator have any availability tomorrow for a call? The Secretary will be on the west coast, but is happy to accommodate the Senator's schedule. Let me know options and I will try and lock this in. Thanks much!

[redacted]

From: Youngen, Angie (Portman) [mailto:Angie_Youngen@portman.senate.gov]
Sent: Tuesday, October 31, 2017 8:31 AM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: [redacted]@treasury.gov>
Subject: RE: catch up call today

Drew/[redacted] Good morning. Would today at 12:45 or 5:30 work for you today?

Or if needing sooner, please let me know.

Angie

From: Isakowitz, Mark (Portman)
Sent: Tuesday, October 31, 2017 8:02 AM
To: Drew.Maloney@treasury.gov; Youngen, Angie (Portman) <Angie_Youngen@portman.senate.gov>
Cc: Scheduler (Portman) <_Scheduler@portman.senate.gov>; [redacted]@treasury.gov
Subject: Re: catch up call today

Yes of course.
Full day but we will work it out.
Adding Angie's direct email address.

Sent from my iPhone

On Oct 31, 2017, at 7:56 AM, "Drew.Maloney@treasury.gov" <Drew.Maloney@treasury.gov> wrote:

> Does the Senator have time for a call with the Secretary today on tax reform?
>
> Thanks
>
> Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: [redacted]
drew.maloney@treasury.gov

401k

From: justin.muzinich@treasury.gov
To: Barbara M. Angus <barbara.angus@mail.house.gov>
Cc: Shahira E. Knight Shahira Knight, EOP [redacted]>
Date: Tue, 31 Oct 2017 14:33:31 -0400

b(5) [redacted]

RE: territorial discussion

From: "Kowalski, Daniel" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=cf6b4ee3710f422fbceecb0020766838-kowalski, dan">

To: "Huang, Gerald (Perdue)" <gerald_huang@perdue.senate.gov>

Date: Tue, 31 Oct 2017 17:47:23 -0400

Thanks. I'll review this information. I'd be happy to discuss distribution when we have it for specific legislation. We'll keep in touch as tax reform moves through the process.

Dan

From: Huang, Gerald (Perdue) [mailto:Gerald_Huang@perdue.senate.gov]
Sent: Tuesday, October 31, 2017 5:29 PM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: territorial discussion

Dan,

b(5) [redacted]

b(5) [redacted] Thanks for meeting with me today, as a word of warning, my boss may want to meet with you and talk about the distribution charts you showed me once we have actual text and you can update the models.

Thanks,

Gerald Huang
Legislative Assistant
Office of Senator David Perdue
455 Russell Senate Office Building
Washington, DC 20510 (202) 224-6607

RE: Call Tonight

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">

To: "Stewart, David" <david.stewart@mail.house.gov>, "Knight, Shahira E. EOP/WHO" <Shahira Knight, EOP [redacted]

Date: Tue, 31 Oct 2017 21:18:01 -0400

Yes, thanks, helpful to see.

From: Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]>
Date: October 31, 2017 at 9:17:17 PM EDT
To: Stewart, David <David.Stewart@mail.house.gov>
Cc: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: RE: Call Tonight

Thanks so much.

From: Stewart, David [mailto:David.Stewart@mail.house.gov]
Sent: Tuesday, October 31, 2017 9:13 PM
To: Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]>
Cc: Justin.Muzinich@Treasury.gov
Subject: Re: Call Tonight

b(5) [redacted]

On Oct 31, 2017, at 9:09 PM, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]> wrote:

> Thanks for letting us know. Getting tons of press inquiries. b(5) [redacted]
> b(5) [redacted]
>
> **From:** Stewart, David [mailto:David.Stewart@mail.house.gov]
> **Sent:** Tuesday, October 31, 2017 9:03 PM
> **To:** Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]>
> **Cc:** Justin.Muzinich@Treasury.gov
> **Subject:** Re: Call Tonight
>
> Announcing shortly formal release on Thursday. Not that that's news.
>
> On Oct 31, 2017, at 7:40 PM, Knight, Shahira E. EOP/WHO Shahira Knight, EOP [redacted]> wrote:
>
> > b(5) [redacted]
> >
> > On Oct 31, 2017, at 7:36 PM, Stewart, David <David.Stewart@mail.house.gov> wrote:
> >
> > > b(5) [redacted]

On Oct 31, 2017, at 7:35 PM, Knight, Shahira E. EOP/WHO
[redacted]> wrote:

[redacted]

On Oct 31, 2017, at 7:26 PM, Stewart, David <David.Stewart@mail.house.gov> wrote:

Reports out that we are delaying until Thursday. [redacted]

On Oct 31, 2017, at 7:17 PM, Jett, Jen <Jen.Jett@mail.house.gov> wrote:

Hi Shahira & Justin ,

Mr. Brady is in with the W&M Members now. I'll do my best to try and get a time frame to call with the Sec. Mnuchin / Dir. Cohn. Thanks for being a little flexible.

Thanks,
Jen

--
Jen Jett
Director of Scheduling
Office of Congressman Kevin Brady, TX-08
Chairman, Committee on Ways & Means
Phone: 202-225-4901

RE: Senator Scott's Investing In Opportunity Act

From: "Newton, Andrew" <andrew.newton@treasury.gov>
To: nick_wyatt@finance.senate.gov
Cc: "Bailey, Bradley" <bradley.bailey@treasury.gov>, "West, Thomas" <thomas.west@treasury.gov>, shay_hawkins@scott.senate.gov, emily_lavery@scott.senate.gov
Date: Thu, 02 Nov 2017 12:56:01 -0400

Hi Nick,

Brad asked me to look into this. b(5) [redacted]
b(5) [redacted]

b(5) [redacted]

We're happy to take a look at any specific language proposals you have or that JCT has given their original recommendation.

Thank you,

Andy

Andrew Newton
Deputy Assistant Secretary for Appropriations and Management
Office of Legislative Affairs
U.S. Treasury Department
202-622-7593

From: Wyatt, Nick (Finance) <Nick_Wyatt@finance.senate.gov>
Date: October 27, 2017 at 4:35:48 PM EDT
To: West, Thomas <Thomas.West@treasury.gov>, Bailey, Bradley <Bradley.Bailey@treasury.gov>
Cc: Hawkins, Shay (Scott) <Shay_Hawkins@scott.senate.gov>, Lavery, Emily (Scott) <Emily_Lavery@scott.senate.gov>
Subject: Senator Scott's Investing In Opportunity Act

Brad and Thomas,
We're working with Senator Scotts office to prep a proposal he's been working on for tax reform, and we've been working with JCT, and have some items that Treasury's input would be helpful in resolving.

The legislation, which is attached with a summary, allows individuals to defer capital gains if they invest in "Opportunity Zones" which are keyed off of New Markets Tax Credits depressed census tracts as designated by a governor.

b(5) [redacted]

b(5) [redacted]

Thank you for your help, Shay and Emily from Senator Scott's office are on this e-mail to answer any questions,
Nick

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

November 5, 2018

Sara Kaiser Creighton
Elizabeth France
John E. Bies
American Oversight
1030 15th Street NW, Suite B255
Washington, DC 20005
foia@americanoversight.org

VIA UPS

Re: *American Oversight v. U.S. Department of the Treasury*, 17-cv-2078-RBW (D.D.C.): Treasury November 6 Production

Counsel:

This letter describes the November 6, 2018 production from the U.S. Department of the Treasury (Treasury) in the above-referenced Freedom of Information Act litigation. Pursuant to the Court's February 2, 2018 Order, Treasury has reviewed and processed 61 documents collected in response to American Oversight's Congressional Communications FOIA Request, 2017-08-121. Via UPS overnight on November 6, Treasury will transmit 48 documents totaling 722 pages, comprising the non-exempt, responsive portions of the records within this collection. The documents are numbered UST 000980 - 1701; portions of these materials are withheld pursuant to Exemptions 5 and 6 of the FOIA. Additional documents are being withheld in their entirety pursuant to Exemption 5, and other documents are not being produced because they are non-responsive and/or duplicative of other materials within this collection; Treasury will provide additional details about these materials later this week.

Treasury is continuing to review records that are potentially responsive to this request and will respond to you again on or before December 5, 2018.

If you have any questions concerning this production or a related matter, please contact Rebecca Kopplin, U.S. Department of Justice, at (202) 514-3953.

Sincerely,

Ryan Law
Office of Privacy, Transparency, and Records
U.S. Department of the Treasury

RE: What do you think of the House tax bill?

From: "Gorman, Tori (Corker)" <tori_gorman@corker.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Thu, 02 Nov 2017 17:36:41 -0400

b(5) [redacted]

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Thursday, November 02, 2017 5:28 PM
To: Gorman, Tori (Corker)
Subject: RE: What do you think of the House tax bill?

b(5) [redacted]

From: Gorman, Tori (Corker) [mailto:Tori_Gorman@corker.senate.gov]
Sent: Thursday, November 02, 2017 5:06 PM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: RE: What do you think of the House tax bill?

b(5) [redacted]

Tori

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Thursday, November 02, 2017 4:48 PM
To: Gorman, Tori (Corker)
Subject: What do you think of the House tax bill?

I'm waiting for a conference call, but would you be available for a call when it is over? 5:15 – 5:30?

Congrats

From: "West, Thomas" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=westt">

To: "Angus, Barbara" <barbara.angus@mail.house.gov>

Date: Fri, 03 Nov 2017 09:45:31 -0400

Barbara, putting all substantive discussion aside for one moment, I just wanted to say thanks and congrats. I saw some of it in action but I still can't imagine what went into getting that thing out. Regardless of where things go from here, you and your team have made an enormous contribution to advancing tax reform.

Best,
Tom

Tom West
(202) 622-6707
thomas.west@treasury.gov

JCT Docs

From: "Angus, Barbara" <barbara.angus@mail.house.gov>
To: "Knight, Shahira E. EOP/WHO" <[redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Fri, 03 Nov 2017 21:51:35 -0400
Attachments: JCX-50-17 W&M Tax Reform Markup.pdf (3.57 MB); x-49-17.pdf (27.52 kB)

Wanted to make sure you see these new documents from JCT – distribution analysis and technical explanation

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
1136 Longworth House Office Building
202.225.5522
barbara.angus@mail.house.gov

DESCRIPTION OF H.R. 1, THE "TAX CUTS AND JOBS ACT"

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on November 6, 2017

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

November 3, 2017
JCX-50-17

CONTENTS

INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on November 6, 2017, on H.R. 1, the "Tax Cuts and Jobs Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Tax Cuts and Jobs Act."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 1, the "Tax Cuts and Jobs Act"* (JCX-50-17), November 3, 2017. This document can be found also on the Joint Committee on Taxation website at www.jct.gov.

TITLE I – TAX REFORM FOR INDIVIDUALS

A. Simplification and Reform of Rates, Standard Deductions, and Exemptions

1. Reduction and simplification of individual income tax rates

Present Law

In general

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. For 2017, the regular individual income tax rate schedules are as follows:

Table 1.–Federal Individual Income Tax Rates for 2017[1]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $9,325	10% of the taxable income
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325
Over $37,950 but not over $91,900	$5,226.25 plus 25% of the excess over $37,950
Over $91,900 but not over $191,650	$18,713.75 plus 28% of the excess over $91,900
Over $191,650 but not over $416,700	$46,643.75 plus 33% of the excess over $191,650
Over $416,700 but not over $418,400	$120,910.25 plus 35% of the excess over $416,700
Over $418,400	$121,505.25 plus 39.6% of the excess over $418,400
Heads of Households	
Not over $13,350	10% of the taxable income
Over $13,350 but not over $50,800	$1,335 plus 15% of the excess over $13,350
Over $50,800 but not over $131,200	$6,952.50 plus 25% of the excess over $50,800
Over $131,200 but not over $212,500	$27,052.50 plus 28% of the excess over $131,200
Over $212,500 but not over $416,700	$49,816.50 plus 33% of the excess over $212,500
Over $416,700 but not over $444,550	$117,202.50 plus 35% of the excess over $416,700
Over $444,550	$126,950 plus 39.6% of the excess over $444,550

If taxable income is:	Then income tax equals:
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $18,650	10% of the taxable income
Over $18,650 but not over $75,900	$1,865 plus 15% of the excess over $18,650
Over $75,900 but not over $153,100	$10,452.50 plus 25% of the excess over $75,900
Over $153,100 but not over $233,350	$29,752.50 plus 28% of the excess over $153,100
Over $233,350 but not over $416,700	$52,222.50 plus 33% of the excess over $233,350
Over $416,700 but not over $470,700	$112,728 plus 35% of the excess over $416,700
Over $470,700	$131,628 plus 39.6% of the excess over $470,700
Married Individuals Filing Separate Returns	
Not over $9,325	10% of the taxable income
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325
Over $37,950 but not over $76,550	$5,226.25 plus 25% of the excess over $37,950
Over $76,550 but not over $116,675	$14,876.25 plus 28% of the excess over $76,550
Over $116,675 but not over $208,350	$26,111.25 plus 33% of the excess over $116,675
Over $208,350 but not over $235,350	$56,364 plus 35% of the excess over $208,350
Over $235,350	$65,814 plus 39.6% of the excess over $235,350

[1] Rev. Proc. 2016-55, 2016-45 I.R.B. 707, sec. 3.01.

Unearned income of children

Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children.[2] Generally, the kiddie tax applies to a child if: (1) the child has not reached the age of 19 by the close of the taxable year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time; (2) the child's unearned income exceeds $2,100 (for 2017); and (3) the child does not file a joint return.[3] The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents. For children above age 17, the kiddie tax applies only to children whose earned income does not exceed one-half of the amount of their support.

Under these rules, the net unearned income of a child (for 2017, unearned income over $2,100) is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of

[2] Sec. 1(g). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

[3] Sec. 1(g)(2).

the child.[4] The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2017), less the child's standard deduction) is taxed at the child's rates, regardless of whether the kiddie tax applies to the child. For these purposes, unearned income is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered, and distributions from qualified disability trusts.[5] In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.[6]

The kiddie tax is calculated by computing the "allocable parental tax." This involves adding the net unearned income of the child to the parent's income and then applying the parent's tax rate. A child's "net unearned income" is the child's unearned income less the sum of (1) the minimum standard deduction allowed to dependents ($1,050 for 2017[7]), and (2) the greater of (a) such minimum standard deduction amount or (b) the amount of allowable itemized deductions that are directly connected with the production of the unearned income.[8]

The allocable parental tax equals the hypothetical increase in tax to the parent that results from adding the child's net unearned income to the parent's taxable income.[9] If the child has net capital gains or qualified dividends, these items are allocated to the parent's hypothetical taxable income according to the ratio of net unearned income to the child's total unearned income. If a parent has more than one child subject to the kiddie tax, the net unearned income of all children is combined, and a single kiddie tax is calculated. Each child is then allocated a proportionate share of the hypothetical increase, based upon the child's net unearned income relative to the aggregate net unearned income of all of the parent's children subject to the tax.

Generally, a child must file a separate return to report his or her income.[10] In such case, items on the parents' return are not affected by the child's income, and the total tax due from the child is the greater of:

1. The sum of (a) the tax payable by the child on the child's earned income and unearned income up to $2,100 (for 2017), plus (b) the allocable parental tax on the child's unearned income, or

[4] Special rules apply for determining which parent's rate applies where a joint return is not filed.

[5] Sec. 1(g)(4) and sec. 911(d)(2).

[6] Sec. 1(h).

[7] Sec. 3.02 of Rev. Proc. 2016-55, *supra*.

[8] Sec. 1(g)(4).

[9] Sec. 1(g)(3).

[10] Sec. 1(g)(6). See Form 8615, Tax for Certain Children Who Have Unearned Income.

2. The tax on the child's income without regard to the kiddie tax provisions.[11]

Under certain circumstances, a parent may elect to report a child's unearned income on the parent's return.[12]

Indexing tax provisions for inflation

Under present law, many parameters of the tax system are adjusted for inflation to protect taxpayers from the effects of rising prices. Most of the adjustments are based on annual changes in the level of the Consumer Price Index for all Urban Consumers ("CPI-U").[13] The CPI-U is an index that measures prices paid by typical urban consumers on a broad range of products, and is developed and published by the Department of Labor.

Among the inflation-indexed tax parameters are the following individual income tax amounts: (1) the regular income tax brackets; (2) the basic standard deduction; (3) the additional standard deduction for aged and blind; (4) the personal exemption amount; (5) the thresholds for the overall limitation on itemized deductions and the personal exemption phase-out; (6) the phase-in and phase-out thresholds of the earned income credit; (7) IRA contribution limits and deductible amounts; and (8) the saver's credit

Capital Gains Rates

In general

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-percent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15-percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

[11] Sec. 1(g)(1).

[12] Sec. 1(g)(7).

[13] Sec. 1(f)(5).

Definitions

Net capital gain

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Adjusted net capital gain

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

Qualified dividend income

Adjusted net capital gain is increased by the amount of qualified dividend income.

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits. Qualified dividends generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of qualified dividend income that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

Dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities are not qualified dividend income.

28-percent rate gain

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

Unrecaptured section 1250 gain

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231

(relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

Description of Proposal

Modification of rates

The proposal replaces the individual income tax rate structure with a new rate structure. The new rate structure generally has four rates: 12 percent, 25 percent, 35 percent, and 39.6 percent.[14] The 25-percent rate bracket begins at taxable income of $90,000 for joint returns, $67,500 for heads of household, $2,550 for estates and trusts, and $45,000 for other individuals. The 35-percent rate bracket begins at taxable income of $260,000 for joint returns, $9,150 for estates and trusts, and $200,000 for other individuals. The 39.6-percent rate bracket begins at taxable income of $1,000,000 for joint returns, $12,500 for estates and trusts, and $500,000 for other individuals.

The bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of $100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

Phaseout of benefit of the 12-percent bracket

For taxpayers with adjusted gross income in excess of $1,000,000 ($1,200,000 in the case of married taxpayers filing jointly), the benefit of the 12-percent bracket, as measured against the 39.6-percent bracket, is phased out at a rate of 6-percent for taxpayers whose AGI is in excess of these amounts. Thus, in the case of a married taxpayer filing a joint return, if AGI is in excess of $1,200,000, regardless of the character of that income, the taxpayer's marginal rate increases by 6-percent while the benefit of $24,840 (27.6-percent of $90,000) phases out over a range of $414,000.

Simplification of tax on unearned income of children

The proposal simplifies the "kiddie tax" by effectively applying the rates applicable to trusts, without the 12-percent rate applicable to trusts, to the net unearned income of a child to whom the proposal applies. Specifically, the amount of taxable income taxed at a 12-percent rate may not exceed the amount of taxable income in excess of the net unearned income of the child. The amount of taxable income taxed at rates below 35 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 35-percent bracket threshold applicable to a trust. The amount of taxable income taxed at rates below 39.6 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 39.6-percent bracket threshold applicable to a trust.

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[14] In all cases the bracket breakpoints for married taxpayers filing a separate return are one-half of the breakpoints for married taxpayers filing jointly.

The following examples illustrate the application of the proposal:

Example 1.−Assume a child to whom the "kiddie tax" applies has $60,000 taxable income of which $50,000 is net unearned income, which would otherwise be treated as ordinary income, such as interest. Assume the 25-percent bracket threshold amount for the taxable year is $45,000 for an unmarried taxpayer, and the 35-percent and 39.6-percent bracket thresholds for a trust are $9,150 and $12,500 respectively.

The child's 25-percent bracket threshold is $10,000 ($60,000 less $50,000), 35-percent bracket threshold is $19,150 ($10,000 plus $9,150), and 39.6-percent bracket threshold is $22,500 ($10,000 plus $12,500). Thus, $10,000 is taxed at a 12-percent rate, $9,150 at a 25-percent rate, $3,350 at a 35-percent rate, and $37,500 at a 39.6-percent rate.

Example 2.−Assume the same facts as Example 1 except that the amount of the child's net unearned income is $20,000 (rather than $50,000).

The child's 25-percent bracket threshold is $40,000 ($60,000 less $50,000), 35-percent bracket threshold is $49,150 ($40,000 plus $9,150), and the 39.6-percent bracket threshold is $52,500 ($40,000 plus $12,500). Thus, $40,000 is taxed at a 10-percent rate, $9,150 at a 25-percent rate, $3,350 at a 35-percent rate, and $7,500 at a 39.6-percent rate.

Replacing CPI-U with chained CPI-U

The proposal requires the use of the chained CPI-U ("C-CPI-U") to index tax parameters currently indexed by the CPI-U. The C-CPI-U is also developed and published by the Department of Labor, and differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. Values that are reset for 2018, such as the bracket thresholds and standard deduction, are indexed by the C-CPI-U in taxable years beginning after December 31, 2018. Other indexed values in the code switch from CPI indexing to C-CPI-U indexing going forward in taxable years beginning after December 31, 2017.

However, the proposal contains an overriding provision to require that all indexing throughout the bill uses the CPI, instead of the C-CPI-U, with respect to periods before January 1, 2023. In effect, all cost-of-living adjustments use the CPI through 2022. In 2023, cost-of-living adjustments use the C-CPI-U going forward.

Maximum rates on capital gains and qualified dividends

The proposal generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates ("15-percent breakpoint") and the 15- and 20-percent rates ("20-percent breakpoint") are the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C-CPI-U in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is $77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for estates and trusts, and $38,600 for other unmarried individuals. The 20-percent breakpoint is $479,000 for joint returns and surviving

spouses (one-half of this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under present law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Enhancement of standard deduction

Present Law

Under present law, an individual who does not elect to itemize deductions may reduce his adjusted gross income ("AGI") by the amount of the applicable standard deduction in arriving at his taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the basic standard deduction is $6,350 for single individuals and married individuals filing separate returns, $9,350 for heads of households, and $12,700 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[15] The amount of the standard deduction is indexed annually for inflation.

In the case of a dependent for whom a deduction for a personal exemption is allowed to another taxpayer, the standard deduction may not exceed the greater of (i) $1,050 (in 2017) or (ii) the sum of $350 (in 2017) plus the individual's earned income.

Description of Proposal

The proposal increases the standard deduction for individuals across all filing statuses. Under the proposal, the amount of the standard deduction is $24,400 for married individuals filing a joint return, $18,300 for head-of-household filers, and $12,200 for all other taxpayers.

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[15] For 2017, the additional amount is $1,250 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,550. An individual who qualifies as both blind and elderly is entitled to two additional standard deductions, for a total additional amount (for 2017) of $2,500 or $3,100, as applicable.

The amount of the standard deduction is indexed for inflation using the chained consumer price index for all-urban consumers for taxable years beginning after December 31, 2019.[16]

The proposal eliminates the additional standard deduction for the aged and the blind.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Repeal of deduction for personal exemptions

Present Law

Under present law, in determining taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2017, the amount deductible for each personal exemption is $4,050. This amount is indexed annually for inflation. The personal exemption amount is phased out in the case of an individual with AGI in excess of $313,800 for taxpayers filing jointly, $287,650 for heads of household and $261,500 for all other filers. In addition, no personal exemption is allowed in the case of a dependent if a deduction is allowed to another taxpayer.

Withholding rules

Under present law, the amount of tax required to be withheld by employers from a taxpayer's wages is based in part on the number of withholding exemptions a taxpayer claims on his Form W-4. An employee is entitled to the following exemptions: (1) an exemption for himself, unless he allowed to be claimed as a dependent of another person; (2) an exemption to which the employee's spouse would be entitled, if that spouse does not file a Form W-4 for that taxable year claiming an exemption described in (1); (3) an exemption for each individual who is a dependent (but only if the employee's spouse has not also claimed such a withholding exemption on a Form W-4); (4) additional withholding allowances (taking into account estimated itemized deductions, estimated tax credits, and additional deductions as provided by the Secretary of the Treasury); and (5) a standard deduction allowance.

Filing requirements

Under present law, an unmarried individual is required to file a tax return for the taxable year if in that year the individual had income which equals or exceeds the exemption amount plus the standard deduction applicable to such individual (*i.e.*, single, head of household, or surviving spouse). An individual entitled to file a joint return is required to do so unless that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is less than the sum of twice the exemption amount plus the basic standard

[16] Thus, the standard deduction is the same for 2018 and 2019.

deduction applicable to a joint return, provided that such individual and his spouse, at the close of the taxable year, had the same household as their home.

Trusts and estates

In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600. A trust is allowed a deduction of $100; $300 if required to distribute all its income currently; and an amount equal to the personal exemption of an individual in the case of a qualified disability trust.

Description of Proposal

The proposal repeals the deduction for personal exemptions.

The proposal modifies the requirements for those who are required to file a tax return. In the case of an individual who is not married, such individual is required to file a tax return if the taxpayer's gross income for the taxable year exceeds the applicable standard deduction. Married individuals are required to file a return if that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is more than the standard deduction applicable to a joint return, provided that: (i) such individual and his spouse, at the close of the taxable year, had the same household as their home; (ii) the individual's spouse does not make a separate return; and (iii) neither the individual nor his spouse is a dependent of another taxpayer who has income (other than earned income) in excess of $500 (indexed for inflation).

The proposal repeals the enhanced deduction for qualified disability trusts.

The proposal provides that the Secretary of the Treasury shall develop rules to determine the amount of tax required to be withheld by employers from a taxpayer's wages.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Maximum rate on business income of individuals

Present Law

Individual income tax rates

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status (*i.e*, single, head of household, married filing jointly, or married filing separately). For 2017, the regular individual income tax rate schedule provides rates of 10, 15, 25, 28, 33, 35, and 39.6 percent.

Under present law, no separate or different tax rate schedule applies to business income of individuals from partnerships, S corporations, or sole proprietorships.

Partnerships

In general

Partnerships generally are treated for Federal income tax purposes as pass-through entities not subject to tax at the entity level.[17] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account by the partners in computing their income tax liability (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).[18] A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.[19] Losses not allowed as a result of that limitation generally are carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) the partner's capital contributions to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) the partner's distributive share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any partnership distributions to the partner.[20] Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.[21]

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.[22] In general, an allocation has substantial economic effect to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation and the allocation substantially affects the dollar amounts to be received by the partners from the partnership independent of tax consequences.[23]

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[17] Sec. 701.

[18] Sec. 702(a).

[19] Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely-held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

[20] Sec. 705.

[21] Sec. 731. Gain or loss may nevertheless be recognized, for example, on the distribution of money or marketable securities, distributions with respect to contributed property, or in the case of disproportionate distributions (which can result in ordinary income).

[22] Sec. 704(b)(2).

[23] Treas. Reg. sec. 1.704-1(b)(2).

Limited liability companies

State laws of every State provide for limited liability companies[24] ("LLCs"), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.[25]

Publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.[26] For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).[27]

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[28]

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[24] The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

[25] Under Treasury regulations promulgated in 1996, any domestic nonpublicly traded unincorporated entity with two or more members generally is treated as a partnership for federal income tax purposes, while any single-member domestic unincorporated entity generally is treated as disregarded for Federal income tax purposes (*i.e.*, treated as not separate from its owner). Instead of the applicable default treatment, however, an LLC may elect to be treated as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701-3. These are known as the "check-the-box" regulations.

[26] Sec. 7704(a). The reasons for change stated by the Ways and Means Committee when the provision was enacted provide in part: "[t]he recent proliferation of publicly traded partnerships has come to the committee's attention. The growth in such partnerships has caused concern about long-term erosion of the corporate tax base." H.R. Rep. 100-391, Omnibus Reconciliation Act of 1987, October 26, 1987, p. 1065.

[27] Sec. 7704(b).

[28] Sec. 7704(c)(2). Qualifying income is defined to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Sec. 7704(d). Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts. However, the exception for partnerships with qualifying income does not apply to any partnership resembling a mutual fund (*i.e.*, that would be described in section 851(a) if it were a domestic corporation), which includes a corporation registered under the Investment Company Act of 1940 (Pub. L. No. 76-768 (1940)) as a management company or unit investment trust (sec. 7704(c)(3)).

S corporations

Generally

For Federal income tax purposes, an S corporation[29] generally is not subject to tax at the corporate level.[30] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account by the S corporation shareholders in computing their income tax liabilities (based on the S corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in its S corporation stock and the indebtedness of the S corporation to such shareholder. Losses not allowed as a result of that limitation generally are carried forward to the next year. A shareholder's adjusted basis in the S corporation stock generally equals the sum of (1) the shareholder's capital contributions to the S corporation and (2) the shareholder's pro rata share of S corporation income, less (1) the shareholder's pro rata share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any S corporation distributions to the shareholder.[31]

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation.

S corporations that were previously C corporations

There are two principal exceptions to the general pass-through treatment of S corporations. Both are applicable only if the S corporation was previously a C corporation. The first applies when the C corporation had appreciated assets,[32] and the second applies when the C corporation had accumulated earnings and profits.[33]

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[29] An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

[30] Secs. 1363 and 1366.

[31] Sec. 1367. If any amount that would reduce the adjusted basis of a shareholder's S corporation stock exceeds the amount that would reduce that basis to zero, the excess is applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. If, after a reduction in the basis of such indebtedness, there is an event that would increase the adjusted basis of the shareholder's S corporation stock, such increase is instead first applied to restore the reduction in the basis of the shareholder's indebtedness. Sec. 1367(b)(2).

[32] Sec. 1374. The period was seven years for taxable years beginning in 2009 and 2010, and five years for taxable years beginning in 2011, 2012, 2013, and 2014. If a C corporation elects to be an S corporation (or transfers assets to an S corporation in a carryover basis transaction), certain net built-in gains that are attributable to the period in which it was a C corporation, and that are recognized during the first five years in which the former C corporation is an S corporation, are subject to corporate-level tax.

[33] Sec. 1375. An S corporation with accumulated earnings and profits is subject to corporate tax on excess net passive investment income (but not in excess of its taxable income, subject to certain adjustments), if more than 25 percent of its gross receipts for the year are passive investment income. Subchapter C earnings and profits generally refers to the earnings of the corporation prior to its subchapter S election which would have been taxable as dividends if distributed to shareholders by the corporation prior to its subchapter S election. If the S corporation

Electing S corporation status

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.[34] Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation.

Sole proprietorships

Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax purposes.[35] Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,[36] for certain excise taxes,[37] and certain information reporting requirements.[38]

Self-employment tax

As part of the financing for Social Security and Medicare benefits, a tax is imposed on the wages of an individual received with respect to his or her employment under the Federal

continues to have C corporation earnings and profits and has gross receipts more than 25 percent of which are passive investment income in each year for three consecutive years, the S corporation election is automatically terminated. Sec. 1362(d)(3). Further, while an S corporation shareholder generally is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation, distributions from an S corporation that was formerly a C corporation generally are taxed to shareholders as dividends to the extent of the S corporation's accumulated earnings and profits. Sec. 1368.

The second principal exception also applies to appreciated assets that are transferred by a C corporation to an S corporation in a carryover basis transaction.

[34] Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

[35] A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701-3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

[36] Treas. Reg. sec. 301.7701-2(c)(2)(iv).

[37] Treas. Reg. sec. 301.7701-2(c)(2)(v).

[38] Treas. Reg. sec. 301.7701-2(c)(2)(vi).

Insurance Contributions Act ("FICA").[39] A similar tax is imposed on the net earnings from self-employment of an individual under the Self-Employment Contributions Act ("SECA").[40]

The SECA tax rate is the combined employer and employee rate for FICA taxes.[41] Under the OASDI component, the rate of tax is 12.4 percent and the amount of earnings subject to this component is capped at $127,200 for 2017. Under the HI component, the rate is 2.9 percent, and the amount of self-employment income subject to the HI component is not capped. An additional 0.9 percent HI tax applies to self-employment income in excess of the same threshold amount that is applicable under FICA (reduced by FICA wages).

For SECA tax purposes, net earnings from self-employment generally includes the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules.[42] Net earnings from self-employment generally includes the distributive share of income or loss from any trade or business of a partnership in which the individual is a partner.

Specified types of income or loss are excluded, such as rentals from real estate in certain circumstances, dividends and interest, and gains or loss from the sale or exchange of a capital asset or from timber, certain minerals, or other property that is neither inventory nor held primarily for sale to customers.

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[39] See Chapter 21 of the Code.

[40] Sec. 1401.

[41] The FICA tax has two components. Under the old-age, survivors, and disability insurance component ("OASDI"), the rate of tax is 12.4 percent, half of which is imposed on the employer, and the other half of which is imposed on the employee. The amount of wages subject to this component is capped at $127,200 for 2017. Under the hospital insurance ("HI") component, the rate is 2.9 percent, also split equally between the employer and the employee. The amount of wages subject to the HI component of the tax is not capped. The employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount for the additional 0.9 percent is $250,000 in the case of a joint return, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case. The threshold amount is not indexed for inflation. The wages of individuals employed by a business in any form (for example, a C corporation) generally are subject to the FICA tax. The employee portion of the FICA tax is collected through withholding from wages. Secs. 3101, 3102, and 3111.

[42] For purposes of determining net earnings from self-employment, taxpayers are permitted a deduction from net earnings from self-employment equal to the product of the taxpayer's net earnings (determined without regard to this deduction) and one-half of the sum of the rates for OASDI (12.4 percent) and HI (2.9 percent), *i.e.*, 7.65 percent of net earnings. This deduction reflects the fact that the FICA rates apply to an employee's wages, which do not include FICA taxes paid by the employer, whereas a self-employed individual's net earnings are economically the equivalent of an employee's wages plus the employer share of FICA taxes. The deduction is intended to provide parity between FICA and SECA taxes. In addition, self-employed individuals may deduct one-half of self-employment taxes for income tax purposes under section 164(f).

An S corporation shareholder's pro rata share of S corporation income is not subject to SECA tax.[43] Nevertheless, courts have held that an S corporation shareholder is subject to FICA tax on the amount of his or her reasonable compensation, even though the amount may have been characterized by the taxpayer as other than wages. This treatment differs from a partner's distributive share of income or loss from the partnership's trade or business, which is generally subject to SECA tax. However, in determining a limited partner's net earnings from self-employment, an exclusion is generally provided for his or her distributive share of partnership income or loss. The exclusion does not apply with respect to guaranteed payments to the limited partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.[44]

Under the Social Security Act, OASDI taxes are directed to Treasury trust funds that provide Social Security benefits, and HI taxes are directed to the Federal Hospital Insurance Trust Fund.

Description of Proposal

Qualified business income of an individual from a partnership, S corporation, or sole proprietorship is subject to Federal income tax at a rate no higher than 25 percent. Qualified business income means, generally, all net business income from a passive business activity plus the capital percentage of net business income from an active business activity, reduced by carryover business losses and by certain net business losses from the current year, as determined under the provision.

Determination of rate

The provision provides that an individual's tax is reduced to reflect a maximum rate of 25 percent on qualified business income.[45]

Taxable income (reduced by net capital gain) that is less than the maximum dollar amount for the 25-percent rate bracket applicable to the taxpayer, is subject to tax at the lower rate brackets applicable to the taxpayer.

Taxable income (reduced by net capital gain) that exceeds the maximum dollar amount for the 25-percent rate bracket applicable to the taxpayer, and that is less than or equal to qualified business income, is subject to tax at a rate of 25 percent. However, taxable income (reduced by net capital gain) that exceeds the maximum dollar amount for the 25-percent rate

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[43] See Rev. Rul. 59-221, 1959-1 C.B. 225, and Rev. Rul. 74-44, 1974-1 C.B. 287. This treatment differs from a partner's distributive share of income or loss from the partnership's trade or business, which is generally subject to SECA tax, as described below. Sec. 1402(a).

[44] Sec. 1402(a).

[45] For taxable years beginning after December 31, 2017, under other provisions of the bill, the regular individual income tax rate schedule provides rates of 12, 25, 35, and 39.6 percent. See section 1001 of the bill (Reduction and simplification of individual income tax rates).

bracket applicable to the taxpayer, and that exceeds qualified business income, is subject to tax in the next higher rate brackets.

The provision provides that a 25-percent tax rate applies generally to dividends received from a real estate investment trust (other than any portion that is a capital gain dividend or a qualified dividend), and applies generally to dividends that are includable in gross income from certain cooperatives.

Qualified business income

Qualified business income is defined as the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity, reduced by the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided in the case of specified service activities or in the case of a taxpayer election to prove out a different percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year. Qualified business income does not include income from a business activity that exceeds these percentages.

Passive business activity and active business activity

A business activity means an activity that involves the conduct of any trade or business. A taxpayer's activities include those conducted through partnerships, S corporations, and sole proprietorships. An activity has the same meaning as under the present-law passive loss rules (section 469). As provided in regulations under those rules, a taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities together or as separate activities (through rental activities generally may not be grouped with other activities unless together they constitute an appropriate economic unit, and grouping real property rentals with personal property rentals is not permitted). It is intended that the activity grouping the taxpayer has selected under the passive loss rules is required to be used for purposes of the passthrough rate rules. For example, an individual taxpayer has an interest in a bakery and a movie theater in Baltimore, and a bakery and a movie theatre in Philadelphia. For purposes of the passive loss rules, the taxpayer has grouped them as two activities, a bakery activity and a movie theatre activity. The taxpayer must group them the same way, that is as two activities, a bakery activity and a movie theatre activity, for purposes of rules of this provision.

Regulatory authority is provided to require or permit grouping as one or as multiple activities in particular circumstances, in the case of specified services activities that would be treated as a single employer under broad related party rules of present law.

A passive business activity generally has the same meaning as a passive activity under the present-law passive loss rules. However, for this purpose, a passive business activity is not defined to exclude a working interest in any oil or gas property that the taxpayer holds directly or through an entity that does not limit the taxpayer's liability. Rather, whether the taxpayer materially participates in the activity is relevant. Further, for this purpose, a passive business

activity does not include an activity in connection with a trade or business or in connection with the production of income.

An active business activity is an activity that involves the conduct of any trade or business and that is not a passive activity. For example, if an individual has a partnership interest in a manufacturing business and materially participates in the manufacturing business, it is considered an active business activity of the individual.

Net business income or loss

To determine qualified business income requires a calculation of net business income or loss from each of an individual's passive business activities and active business activities. Net business income or loss is determined separately for each business activity.

Net business income is determined by appropriately netting items of income, gain, deduction and loss with respect to the business activity. The determination takes into account these amounts only to the extent the amount affects the determination of taxable income for the year. For example, if in a taxable year, a business activity has 100 of ordinary income from inventory sales, and makes an expenditure of 25 that is required to be capitalized and amortized over 5 years under applicable tax rules, the net business income is 100 minus 5 (current-year ordinary amortization deduction), or 95. The net business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Net business income or loss also includes any amounts received by the individual taxpayer as wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity. For example, if an individual shareholder of an S corporation engaged in a business activity is paid wages or director's fees by the S corporation, the amount of wages or director's fees is included in net business income or loss with respect to the business activity. This rule is intended to ensure that the amount eligible for the 25-percent tax rate is not erroneously reduced because of compensation for services or other specified amounts that are paid separately (or treated as separate) from the individual's distributive share of passthrough income.

Net business income or loss does not include specified investment-related income, deductions, or loss. Specifically, net business income does not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income other than that which is properly allocable to a trade or business, (4) the excess of gain over loss from commodities transactions, other than those entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business, (5) the excess of foreign currency gains over foreign currency losses from section 988 transactions, other than transactions directly related to the business needs of the business activity, (6) net income from notional principal contracts, other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as

capital assets), and (7) any amount received from an annuity that is not used in the trade or business of the business activity. Net business income does not include any item of deduction or loss properly allocable to such income.

<u>Carryover business loss</u>

Solely for purposes of determining qualified business income eligible for a maximum rate of 25 percent, the carryover business loss from the preceding taxable year reduces qualified business income in the current taxable year.[46] The carryover business loss is the excess of (1) the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided under rules for determining the capital percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year, over (2) the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity. There is no time limit on carryover business losses. For example, an individual has two business activities that give rise to a net business loss of 30 and 40, respectively, in year one, giving rise to a carryover business loss of 70 to year two. If the two business activities each give rise to net business income of 20 in year two, a carryover business loss of 30 is carried to year three (that is, <70> - (20 + 20) = <30>).

<u>Capital percentage</u>

The capital percentage is the percentage of net business income from an active business activity that is included in qualified business income.

In general, the capital percentage is 30 percent, except as provided in the case of application of an increased percentage for capital-intensive business activities, in the case of specified service activities, and in the case of application of the rule for capital-intensive specified service activities.

The capital percentage is reduced if the portion of net business income represented by the sum of wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity exceeds the difference between 100 percent and the capital percentage. For example, if net business income from an individual's active business activity conducted through an S corporation is 100, including 75 of wages that the S corporation pays the individual, the otherwise applicable capital percentage is reduced from 30 percent to 25 percent.

<u>Increased percentage for capital-intensive business activities</u>.−A taxpayer may elect the application of an increased percentage with respect to any active business activity other than a specified service activity (described below). The election applies for the taxable year it is made

[46] The determination of carryover business loss, for purposes of determining the amount of qualified business income eligible for a maximum rate of 25 percent, does not affect the extent to which items of income, gain, deduction, and loss are included in taxable income. For example, the carryforward of net operating losses and the treatment of passive activity losses continue to affect the determination of taxable income as provided in sections 172 and 469, respectively.

and each of the next four taxable years. The election is to be made no later than the due date (including extensions) of the return for the taxable year made, and is irrevocable. The percentage under the election is the applicable percentage (described below) for the five taxable years of the election.

Calculation of applicable percentage.–The applicable percentage is the percentage applied in lieu of the capital percentage in the case of an election with respect to capital-intensive business activities, or with respect to capital-intensive specified service activities (below). Once an election is made, the applicable percentage (not the capital percentage) determines the portion of the net business income or loss from the activity for the taxable year that is taken into account in determining qualified business income subject to Federal income tax at a rate no higher than 25 percent.

The applicable percentage is determined by dividing (1) the specified return on capital for the activity for the taxable year, by (2) the taxpayer's net business income derived from that activity for that taxable year. The specified return on capital for any active business activity is determined by multiplying a deemed rate of return times the asset balance for the activity for the taxable year, and reducing the product by interest expense deducted by the activity for the taxable year. The deemed rate of return for this purpose is the short-term AFR plus 7 percentage points. The asset balance for this purpose is the adjusted basis of property used in connection with the activity as of the end of the taxable year, determined without taking into account of basis adjustments for bonus depreciation under section 168(k) or expensing under section 179. In the case of an active business activity conducted through a partnership or S corporation, the taxpayer takes into account his distributive share of the asset balance of the partnership's or S corporation's adjusted basis of property used in connection with the activity. Property used in connection with an activity is property described in section 1221(a)(2), which includes property of a character which is subject to the allowance for depreciation provided in section 167 and real property used in the trade or business. For example, if an individual's active business activity has on hand at the end of the taxable year machinery with an adjusted basis of 100 (determined without taking into account basis adjustments for bonus depreciation under section 168(k) or expensing under section 179) and cash of 50, then the asset balance for the activity is 100. Regulatory authority is provided to ensure that in determining asset balance, no amount is taken into account for more than one activity.

Specified service activities.–In the case of an active business activity that is a specified service activity, generally the capital percentage is 0 and the percentage of any net business loss from the specified service activity that is taken into account as qualified business income is 0 percent. Regulatory authority is provided to treat all specified services activities of an individual as a single business activity to the extent the activities would be treated as a single employer for purposes of aggregation rules.

A specified service activity means any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, or investing, trading, or dealing in securities, partnership interests, or commodities. For this purpose a security and a commodity have the meanings

provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

Capital-intensive specified service activities.−A taxpayer may annually elect the application of an increased percentage with respect to any active business activity that is specified service activity, provided the applicable percentage for the taxable year is at least 10 percent.

Self-employment tax

The proposal provides that only the labor percentage of gross income less deductions from a trade or business carried on by an individual, including an individual who is a partner or S corporation shareholder in a trade or business carried on by a partnership or S corporation, are taken into account in determining net earnings from self-employment. The labor percentage is the excess (expressed as a percentage) of one minus the capital percentage (or applicable percentage, as the case may be).

Thus, the proposal provides that net earnings from self-employment generally include the individual's pro rata share of nonseparately computed income or loss from any trade or business of an S corporation in which the individual is a stockholder. Proper adjustment is made for wages paid in a trade or business carried on by an S corporation to a taxpayer who is a shareholder. For example, an S corporation shareholder is paid wages of 20 with respect to a trade or business conducted by the S corporation, and after the deduction for wages, and has a pro rata share of income from the S corporation of 100. Assume the labor percentage is 70 percent. In determining net earnings from self-employment, the 20 of wages is added to the 100 pro rata share before applying the labor percentage of 70 percent (120 x .7 = 84). The 84 amount is then reduced by the wages of 20, yielding net earnings from self-employment of 64. Present-law rules imposing FICA tax on the wages of 20 are not changed by the provision.

The proposal repeals the present-law exclusion for a limited partner's distributive share of partnership income or loss in determining net earnings from self-employment (including repeal of the exception for partnership guaranteed payments in the nature of remuneration for services). Thus, under the proposal, limited partners are treated the same as other partners for purposes of determining net earnings from self-employment.

The proposal modifies the exceptions that apply in determining net earnings from self-employment by providing that rentals from real estate and personal property leased with the real estate are not among the exceptions. The proposal retains the present-law exceptions for dividends and interest, and gains or loss from the sale or exchange of a capital asset, or gains or losses from other property that is neither inventory nor held primarily for sale to customers.

Effective Date

The provision is effective for taxable years beginning after December 31, 2017. A transition rule provides that for fiscal year taxpayers whose taxable year includes December 31, 2017, a proportional benefit of the reduced rate under the provision is allowed for the period beginning January 1, 2018, and ending on the day before the beginning of the taxable year beginning after December 31, 2017.

B. Simplification and Reform of Family and Individual Tax Credits

1. Enhancement of child tax credit and family tax credit

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against both the regular tax and the alternative minimum tax ("AMT"). To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit[47] (the "additional child tax credit") equal to 15 percent of earned income in excess of $3,000 (the "earned income" formula).

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. At the taxpayer's election, combat pay may be treated as earned income for these purposes. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possession) is not taken into account as income and is not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the

[47] The refundable credit may not exceed the maximum credit per child of $1,000.

amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Description of Proposal

The proposal consolidates the child tax credit into a new family tax credit. The family credit consists of a $1,600 credit per qualifying child under the age of 17, and $300 for each of the taxpayer (both spouses in the case of married taxpayers filing a joint return) and each dependent of the taxpayer who is not a qualifying child under age 17.

The proposal generally retains the present-law definition of dependent. However, under the proposal, a qualifying child is eligible for the $1,600 credit only if such child is a citizen or national of the United States.

The family credit phases out AGI of $230,000 for married taxpayers filing joint returns and $115,000 for other individuals. The credit is refundable under rules similar to the present law additional child tax credit. That is, to the extent the credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15 percent of earned income in excess of $3,000.[48] The refundable credit is limited to $1,000 times the number of qualifying children under the age of 17 claimed on the return. This $1,000 dollar limitation is indexed for inflation.

The proposal requires that the taxpayer include the name and taxpayer identification number of each qualifying child and dependent on the tax return for each taxable year. In the case of a refundable child tax credit, the taxpayer must include the taxpayer's Social Security number on the tax return for the taxable year (in the case of a joint return either spouse's Social Security number will suffice).[49]

The $300 credit for the taxpayer, spouse, and non-child dependents of the taxpayer expires for taxable years beginning after December 31, 2022.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Repeal of credit for the elderly and permanently disabled

Present Law

Certain taxpayers who are over the age of 65 or retired on account of permanent and total disability may claim a nonrefundable credit. The maximum credit is 15 percent of $5,000 for a

[48] The alternate formula described in the present law section applies to the refundable portion of the family credit as well.

[49] See description of sec. 1103 of the bill.

return where one individual qualifies and $7,500 on a joint return where both spouses qualify.[50] Thus, the maximum credit amounts are $750 and $1,125, respectively.

The credit base is reduced by one half of the amount by which the taxpayer's adjusted gross income exceeds $7,500 if the taxpayer is unmarried, $10,000 if the taxpayer is married and files a joint return, or $5,000 if the taxpayer is married and files a separate return.[51] Thus, the credit base is phased down to zero when adjusted gross income exceeds $17,500 for an unmarried person, $20,000 for a married couple filing a joint return where only one spouse qualifies for the credit, $25,000 for a joint return where both spouses qualify, and $12,500 for a married person filing a separate return.

Additionally, the credit base is reduced by certain items of income otherwise exempt from tax: (1) benefits under Title II of the Social Security Act; (2) retirement benefits under the Railroad Retirement Act of 1974; (3) disability benefits paid by the Veterans Administration, except for benefits payable on account of personal injuries or sickness resulting from active service in the armed forces; and (4) pensions, annuities, and disability benefits exempted from tax by any provision not in the Code.[52]

To qualify for the credit, a taxpayer must, at the end of the taxable year, be at least 65 years old or retired on account of permanent and total disability.[53] Permanent and total disability exists if, at the time of retirement, the taxpayer was "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.[54]

Description of Proposal

The proposal repeals the credit for the elderly and permanently disabled.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[50] Sec. 22(a).

[51] Sec. 22(d).

[52] Sec. 22(c)(3).

[53] Sec. 22(b).

[54] Sec. 22(e)(3).

3. Repeal of credit for adoption expenses

Present Law

In general

A tax credit is allowed for qualified adoption expenses paid or incurred by a taxpayer subject to a maximum credit amount per eligible child.[55] An eligible child is an individual who: (1) has not attained age 18; or (2) is physically or mentally incapable of caring for himself or herself. The maximum credit is applied per child rather than per year. Therefore, while qualified adoption expenses may be incurred in one or more taxable years, the tax credit per adoption of an eligible child may not exceed the maximum credit.

For taxable years beginning in 2017, the maximum credit amount is $13,570, and the credit is phased out ratably for taxpayers with modified adjusted gross income ("AGI") above a certain amount. In 2017, the phase out range begins at modified AGI of $203,540, with no credit allowed for taxpayers with a modified AGI of $243,540. Modified AGI is the sum of the taxpayer's AGI plus amounts excluded from income under sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands and residents of Puerto Rico, respectively).

Special needs adoptions

In the case of a special needs adoption finalized during a taxable year, the taxpayer may claim as an adoption credit the amount of the maximum credit minus the aggregate qualified adoption expenses with respect to that adoption for all prior taxable years. A special needs child is an eligible child who is a citizen or resident of the United States whom a State has determined: (1) cannot or should not be returned to the home of the birth parents; and (2) has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions, or physical, mental, or emotional handicaps) because of which the child cannot be placed with adoptive parents without adoption assistance.

Qualified adoption expenses

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that are: (1) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (2) not incurred in violation of State or Federal law, or in carrying out any surrogate parenting arrangement; (3) not for the adoption of the child of the taxpayer's spouse; and (4) not reimbursed (*e.g.*, by an employer).

Description of Proposal

The proposal repeals the credit for adoption expenses.

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[55] Sec. 23.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

4. Termination of credit for interest on certain home mortgages

Present Law

Qualified governmental units can elect to exchange all or a portion of their qualified mortgage bond authority for authority to issue mortgage credit certificates ("MCCs").[56] MCCs entitle homebuyers to a nonrefundable income tax credit for a specified percentage of interest paid on mortgage loans on their principal residences. The tax credit provided by the MCC may be carried forward three years. Once issued, an MCC generally remains in effect as long as the residence being financed is the certificate-recipient's principal residence. MCCs generally are subject to the same eligibility and targeted area requirements as qualified mortgage bonds.[57]

Description of Proposal

No credit is allowed with respect to any MCC issued after December 31, 2017.

Effective Date

The provision applies to taxable years ending after December 31, 2017. Credits continue for interest paid on mortgage loans on principal residences for which MCCs have been issued on or before December 31, 2017.

5. Repeal of credit for plug-in electric drive motor vehicles

Present Law

A credit is available for new four-wheeled vehicles (excluding low speed vehicles and vehicles weighing 14,000 pounds or more) propelled by a battery with at least 4 kilowatt-hours of electricity that can be charged from an external source.[58] The base credit is $2,500 plus $417 for each kilowatt-hour of additional battery capacity in excess of 4 kilowatt-hours (for a maximum credit of $7,500). Qualified vehicles are subject to a 200,000 vehicle-per-manufacturer limitation. Once the limitation has been reached the credit is phased down over four calendar quarters.

Description of Proposal

The proposal repeals the credit for plug-in electric drive motor vehicles.

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[56] Sec. 25.

[57] Sec. 143.

[58] Sec. 30D.

Effective Date

The proposal is effective for vehicles placed in service in taxable years beginning after December 31, 2017.

6. Social security requirement for refundable portion of child credit, American Refundable Credit Program Integrity

Present Law

Earned income credit

Low and moderate-income taxpayers may be eligible for the refundable earned income credit ("EIC"). Eligibility for the EIC is based on the taxpayer's earned income, adjusted gross income, investment income, filing status, and work status in the United States. The amount of the EIC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income.

The earned income credit generally equals a specified percentage of earned income[59] up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phase-out range. For taxpayers with earned income (or adjusted gross income ("AGI")), if greater) in excess of the beginning of the phase-out range, the maximum EIC amount is reduced by the phase-out rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phase-out range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phase-out range, no credit is allowed.

An individual is not eligible for the EIC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $3,450 (for 2017). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (taxable and tax-exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income (if greater than zero) that is not self-employment income.

The EIC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

Child tax credit[60]

An individual may claim a tax credit of $1,000 for each qualifying child under the age of 17. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

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[59] Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the individual's net self-employment earnings.

[60] See description of sec. 1101 of the bill for the proposal's modifications to the child tax credit.

The aggregate amount of allowable child credits is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable aggregate child tax credit ("CTC") amount is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("modified AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income[61] earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The child tax credit is allowable against both the regular tax and the alternative minimum tax ("AMT"). To the extent the credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the "additional child tax credit") equal to 15 percent of earned income in excess of a threshold dollar amount of $3,000 (the "earned income" formula).

Families with three or more qualifying children may determine the additional child tax credit using the "alternative formula" if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's EIC.

As with the EIC, earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, the additional child tax credit is based on earned income only to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes and thus are not considered earned income for purposes of the additional child tax credit.

American Opportunity credit[62]

The American Opportunity credit provides individuals with a tax credit of up to $2,500 per eligible student per year for qualified tuition and related expenses (including course materials) paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25 percent on the next $2,000 of qualified tuition and related expenses.

The American Opportunity credit is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The credit may be claimed against a taxpayer's AMT liability.

[61] Sec. 911.

[62] See description of sec. 1201 of the bill for the proposal's modifications to the American Opportunity credit.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. A refundable credit is a credit which, if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

No credit is allowed to a taxpayer who fails to include the taxpayer identification number of the student to whom the qualified tuition and related expenses relate.

Taxpayer identification number requirements

Any individual filing a U.S. tax return is required to state his or her taxpayer identification number on such return. Generally, a taxpayer identification number is the individual's Social Security number ("SSN").[63] However, in the case of an individual who is not eligible to be issued an SSN, but who has a tax filing obligation, the Internal Revenue Service ("IRS") issues an individual taxpayer identification number ("ITIN") for use in connection with the individual's tax filing requirements.[64] An individual who is eligible to receive an SSN may not obtain an ITIN for purposes of his or her tax filing obligations.[65] An ITIN does not provide eligibility to work in the United States or claim Social Security benefits.

Examples of individuals who are not eligible for SSNs, but potentially need ITINs in order to file U.S. returns include a nonresident alien filing a claim for a reduced withholding rate under a U.S. income tax treaty, a nonresident alien required to file a U.S. tax return,[66] an individual who is a U.S. resident alien under the substantial presence test and who therefore must file a U.S. tax return,[67] a dependent or spouse of the prior two categories of individuals, or a dependent or spouse of a nonresident alien visa holder.

An individual is ineligible for the EIC (but not the child tax credit) if he or she does not include a valid SSN and the qualifying child's valid SSN (and, if married, the spouse's SSN) on his or her tax return. For these purposes, the Code defines an SSN as a Social Security number issued to an individual, other than an SSN issued to an individual solely for the purpose of applying for or receiving federally funded benefits.[68] If an individual fails to provide a correct taxpayer identification number, such omission will be treated as a mathematical or clerical error by the IRS.

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[63] Sec. 6109(a).

[64] Treas. Reg. Sec. 301.6109-1(d)(3)(i).

[65] Treas. Reg. Sec. 301.6109-1(d)(3)(ii).

[66] For instance, in the case of an individual that has income which is effectively connected with a United States trade or business, such as the performance of personal services in the United States.

[67] Such an individual would have a filing requirement without regard to whether the individual is lawfully present or has work authorization.

[68] Sec. 205(c)(2)(B)(i)(II) (and that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act.

A taxpayer who resides with a qualifying child may not claim the EIC with respect to the qualifying child if such child does not have a valid SSN. The taxpayer also is ineligible for the EIC for workers without children because he or she resides with a qualifying child. However, if a taxpayer has two or more qualifying children, some of whom do not have a valid SSN, the taxpayer may claim the EIC based on the number of qualifying children for whom there are valid SSNs.

Description of Proposal

The proposal provides that a taxpayer must have a Social Security number that is valid for employment in the United States (that is, the taxpayer must be a United States citizen, permanent resident, or have a visa that allows him or her to work temporarily in the United States) in order to claim the refundable portion of the CTC. Additionally, under the proposal taxpayers who use as their taxpayer identification number a Social Security number issued for non-work reasons, such as for purposes of receiving Federal benefits or for any other reason, are not eligible for the refundable portion of the CTC or EIC.

Additionally, the proposal provides that in order to claim the American Opportunity credit, the identification number provided with respect to the student to whom the tuition and related expenses relates is a Social Security number.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

C. Simplification and Reform of Education Incentives

1. Reform of American opportunity tax credit and repeal of lifetime learning credit

Present Law

American Opportunity credit

The American Opportunity credit provides individuals with a tax credit of up to $2,500 per eligible student per year for qualified tuition and related expenses (including course materials) paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25 percent on the next $2,000 of qualified tuition and related expenses. The credit may not be claimed for more than four taxable years with respect to any student.

The American Opportunity credit is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The credit may be claimed against a taxpayer's AMT liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. A refundable credit is a credit which, if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

A taxpayer may not claim the American Opportunity credit if the qualified tuition and related expenses for the enrollment or attendance of a student, if such student has been convicted of a Federal or State felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year.[69]

Lifetime learning credit

Individual taxpayers may be eligible to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. Up to $10,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit *(i.e.*, the maximum credit per taxpayer return is $2,000).

In contrast to the American Opportunity credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years.[70] Also in contrast to the American Opportunity credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return does not vary based on the number of students in the taxpayer's family—that is, the American Opportunity credit is computed on a per-student basis while the Lifetime Learning credit is computed on a family-wide basis. The Lifetime Learning credit amount that a

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[69] Sec. 25A(b)(2)(D).

[70] Sec. 25A(a)(2).

taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between $56,000 and $66,000 ($112,000 and $132,000 for married taxpayers filing a joint return) in 2017.

Description of Proposal

The proposal modifies the American Opportunity credit[71] by providing that a credit may be claimed with respect to a student for five taxable years (rather than four taxable years under present law). For a credit claimed with respect to the student's fifth taxable year, the credit is half the value of the AOTC that is applicable to the first four taxable years (the refundable portion of the credit is 40-percent of the half-value credit).

The proposal repeals the provision that denies the credit with respect to qualified tuition and related expenses for the enrollment or attendance of any student who has been convicted of a felony offense consisting of the possession or distribution of a controlled substance.

The proposal repeals the lifetime learning credit.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

2. Consolidation and modification of education savings rules

Present Law

Coverdell education savings accounts

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.[72] Annual contributions to Coverdell education savings accounts may not exceed $2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return); the AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell education savings account generally are subject to tax when withdrawn.[73] However, distributions from a Coverdell education savings account

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[71] The proposal also repeals the Hope credit, a precursor to the American Opportunity credit which since 2009 has been largely superseded in the Code by the American Opportunity credit.

[72] Sec. 530.

[73] In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

are excludable from the gross income of the distributee (*i.e.*, the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell education savings account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.[74]

Tax-free (and free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

Qualified education expenses include qualified elementary and secondary expenses and qualified higher education expenses. Such qualified education expenses generally include only out-of-pocket expenses. They do not include expenses covered by employer-provided educational assistance or scholarships for the benefit of the beneficiary that are excludable from gross income.

The term qualified elementary and secondary school expenses, means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and (3) the purchase of any computer technology or equipment (as defined in section 170(e)(6)(F)(i)) or internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is predominantly educational in nature.

The term qualified higher education expenses includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis.[75] Moreover, qualified higher education expenses include certain room and board expenses for any period during which the

[74] This 10-percent additional tax does not apply if a distribution from an education savings account is made on account of the death or disability of the designated beneficiary, or if made on account of a scholarship received by the designated beneficiary.

[75] Qualified higher education expenses are defined in the same manner as for qualified tuition programs.

beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified tuition program for the benefit of the beneficiary of the Coverdell education savings account.[76]

Section 529 qualified tuition programs

In general

A qualified tuition program is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). Section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.[77] In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary. Decisions with respect to the contract or account are typically made by an individual who is not the designated beneficiary. Qualified tuition accounts or contracts generally require the designation of a person (generally referred to as an "account owner")[78] whom the program administrator (oftentimes a third party administrator retained by the State or by the educational institution that established the program) may look to for decisions, recordkeeping, and reporting with respect to the account established for a designated beneficiary. The person or persons who make the contributions to the account need not be the same person who is regarded as the account owner for purposes of administering the account. Under many qualified tuition programs, the account owner generally has control over the account or contract, including the ability to change designated beneficiaries and to withdraw funds at any time and for any purpose. Thus, in practice, qualified tuition accounts or contracts generally involve a

[76] Sec. 530(b)(2)(B).

[77] For purposes of this description, the term "account" is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

[78] Section 529 refers to contributors and designated beneficiaries, but does not define or otherwise refer to the term "account owner," which is a commonly used term among qualified tuition programs.

contributor, a designated beneficiary, an account owner (who oftentimes is not the contributor or the designated beneficiary), and an administrator of the account or contract.

Qualified higher education expenses

For purposes of receiving a distribution from a qualified tuition program that qualifies for favorable tax treatment under the Code, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time. Qualified higher education expenses include the purchase of any computer technology or equipment, or Internet access or related services, if such technology or services were to be used primarily by the beneficiary during any of the years a beneficiary is enrolled at an eligible institution.

Contributions to qualified tuition programs

Contributions to a qualified tuition program must be made in cash. Section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions generally are treated as a completed gift eligible for the gift tax annual exclusion. Contributions are not tax deductible for Federal income tax purposes, although they may be deductible for State income tax purposes. Amounts in the account accumulate on a tax-free basis (*i.e.*, income on accounts in the plan is not subject to current income tax).

A qualified tuition program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon) more than two times in any calendar year, and must provide separate accounting for each designated beneficiary. A qualified tuition program may not allow any interest in an account or contract (or any portion thereof) to be used as security for a loan.

Description of Proposal

Under the proposal, no new contributions are permitted into Coverdell savings accounts after December 31, 2017. However, rollovers of account balances from one Coverdell education savings account to another pre-existing Coverdell education savings account benefiting another beneficiary remain permitted after this date. Additionally, the proposal allows section 529 plans to receive rollover contributions from Coverdell education savings accounts.

The proposal modifies section 529 plans to allow such plans to distribute not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious elementary or secondary school. This limitation applies on a per-student basis, rather than a per-account basis. Thus, under the proposal, although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of $10,000 in distributions free of tax,

regardless of whether the funds are distributed from multiple accounts. Any excess distributions received by the individual would be treated as a distribution subject to tax under the general rules of section 529.

The proposal also modifies section 529 plans to allow such plan distributions to be used for certain expenses, including books, supplies, and equipment, required for attendance in a registered apprenticeship program. Registered apprenticeship programs are apprenticeship programs registered and certified with the Secretary of Labor.

Finally, the proposal specifies that nothing in this section shall prevent an unborn child from qualifying as a designated beneficiary. For these purposes, an unborn child means a child in utero, and the term child *in utero* means a member of the species *homo sapiens*, at any stage of development, who is carried in the womb.

Effective Date

The proposal applies to contributions made in taxable years beginning after December 31, 2017.

3. Reforms to discharge of certain student loan indebtedness

Present Law

Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.[79]

Student loans eligible for this special rule must be made to an individual to assist the individual in attending an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses. The loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation.

In addition, an individual's gross income does not include amounts from the forgiveness of loans made by educational organizations (and certain tax-exempt organizations in the case of refinancing loans) out of private, nongovernmental funds if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans (not just loans made by educational organizations) and the student is not employed by the

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[79] Sec. 108(f).

lender organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent on the student working in an occupation or area with unmet needs and such work must be performed for, or under the direction of, a tax-exempt charitable organization or a governmental entity.

Finally, an individual's gross income does not include any loan repayment amount received under the National Health Service Corps loan repayment program, certain State loan repayment programs, or any amount received by an individual under any State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the State).

Description of Proposal

The proposal modifies the exclusion of student loan discharges from gross income, by including within the exclusion certain discharges on account of death or disability. Loans eligible for the exclusion under the proposal are loans made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation, or (5) private education loans (for this purpose, private education loan is defined in section 140(7) of the Consumer Protection Act).[80]

Under the proposal, the discharge of a loan as described above is excluded from gross income if the discharge was pursuant to the death or total and permanent disability of the student.[81]

Additionally, the proposal modifies the gross income exclusion for amounts received under the National Health Service Corps loan repayment program or certain State loan repayment programs to include any amount received by an individual under the Indian Health Service loan repayment program.[82]

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[80] 15 U.S.C. 1650(7).

[81] Although the proposal makes specific reference to those provisions of the Higher Education Act of 1965 that discharge William D. Ford Federal Direct Loan Program loans, Federal Family Education Loan Program loans, and Federal Perkins Loan Program loans in the case of death and total and permanent disability, the proposal also contains a provision providing generally for an exclusion in the case of a student loan discharged on account of the death or total and permanent disability of the student, in addition to those specific statutory references.

[82] Section 108 of the Indian Health Care Improvement Act established the Indian Health Service loan repayment program to assure a sufficient supply of trained health professionals needed to provide health care services to Indians. Pub. L. No. 94-437, as amended by Pub. L. No. 100-713, sec. 108, and Pub. L. No. 102-573, sec. 106, and as amended, and permanently reauthorized by Pub. L. No. 111-148, sec. 10221.

Effective Date

The proposal applies to discharges of loans after, and amounts received after, December 31, 2017.

4. Repeal of deduction for student loan interest

Present Law

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit.[83] Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.[84]

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending on at least a half-time basis (1) eligible educational institutions, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. The cost of attendance is reduced by any amount excluded from gross income under the exclusions for qualified scholarships and tuition reductions, employer-provided educational assistance, interest earned on education savings bonds, qualified tuition programs, and Coverdell education savings accounts, as well as the amount of certain other scholarships and similar payments.

The maximum allowable deduction per year is $2,500.[85] For 2017, the deduction is phased out ratably for taxpayers with AGI between $65,000 and $80,000 ($135,000 and $165,000 for married taxpayers filing a joint return). The income phase-out ranges are indexed for inflation and rounded to the next lowest multiple of $5,000.

Description of Proposal

The proposal repeals the deduction for student loan interest.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[83] Sec. 221.

[84] Sec. 221(c).

[85] Sec. 221(b)(1).

5. Repeal of deduction for qualified tuition and related expenses

Present Law

An individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[86] Qualified tuition includes tuition and fees required for the enrollment or attendance by the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution. The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic term beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose AGI for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose AGI does not exceed $80,000 ($160,000 in the case of a joint return).[87] No deduction is allowed for an individual whose AGI exceeds the relevant AGI limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2016.

Description of Proposal

The proposal repeals the deduction for qualified tuition and related expenses.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Repeal of exclusion for educational assistance programs

Present Law

Up to $5,250 annually of educational assistance provided by an employer to an employee is excludible from the employee's gross income, provided that certain requirements are satisfied.[88] Nondiscrimination rules[89] apply and the educational assistance must be provided

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[86] Sec. 222(a).

[87] Sec. 222(b)(2)(B).

[88] Sec. 127(a).

[89] The employer's educational assistance program must not discriminate in favor of highly compensated employees, within the meaning of Sec. 414(q). In addition, no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program

pursuant to a separate written plan of the employer. The exclusion applies to both graduate and undergraduate courses, and applies only with respect to education provided to the employee (*i.e.*, it does not apply to education provided to the spouse or a child of the employee). Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

For purposes of the exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include (1) tools or supplies that may be retained by the employee after completion of a course, (2) meals, lodging, or transportation, and (3) any education involving sports, games, or hobbies.

Description of Proposal

The proposal repeals the exclusions from gross income and wages for educational assistance programs.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

7. Repeal of exclusion for interest on United States savings bonds used to pay higher education tuition and fees

Present Law

Interest earned on a qualified U.S. Series EE savings bond issued after 1989 is excludable from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[90] Qualified higher education expenses include tuition and fees (but not room and board expenses) required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at certain eligible higher educational institutions. The amount of qualified higher education expenses taken into account for purposes of the exclusion is reduced by the amount of such expenses taken into account in determining the Hope, American Opportunity, or Lifetime Learning credits claimed by any taxpayer, or taken into account in determining an exclusion from gross income for a distribution from a qualified tuition program or a Coverdell education savings account, with respect to a particular student for the taxable year.

The exclusion is phased out for certain higher-income taxpayers, determined by the taxpayer's modified AGI during the year the bond is redeemed. For 2017, the exclusion is

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can be provided for the class of individuals consisting of more-than-five-percent owners of the employer and the spouses or dependents of such more-than-five-percent owners.

[90] Sec. 135.

phased out for taxpayers with modified AGI between $78,150 and $93,150 ($117,250 and $147,250 for married taxpayers filing a joint return). To prevent taxpayers from effectively avoiding the income phaseout limitation through the purchase of bonds directly in the child's name, the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

Description of Proposal

The proposal repeals the exclusion of interest earned on U.S. Series EE savings bonds.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

8. Repeal of exclusion for qualified tuition reductions

Present Law

Qualified tuition reductions for certain education provided to employees (and their spouses and dependents[91]) of certain educational organizations are excludible from gross income.[92] The tuition reduction is subject to nondiscrimination rules.[93] The exclusion generally applies below the graduate level, and to teaching and research assistants who are students at the graduate level, but does not apply to any amount received by a student that represents payment for teaching, research or other services by the student required as a condition for receiving the tuition reduction. Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

Description of Proposal

The proposal repeals the exclusions from gross income and wages for qualified tuition reductions.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017.

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[91] Individuals described under the rules of section 132(h).

[92] Educational organization described in section 170(b)(1)(A)(ii). Sec. 117(d)(2).

[93] The exclusion applies with respect to highly compensated employees, within the meaning of Sec. 414(q), only if such tuition reductions are available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification established by the employer, such that the benefit does not discriminate in favor of highly compensated employees.

D. Simplification and Reform of Deductions

1. Repeal of overall limitation on itemized deductions

Present Law

The total amount of most otherwise allowable itemized deductions (other than the deductions for medical expenses, investment interest and casualty, theft or gambling losses) is limited for certain upper-income taxpayers.[94] All other limitations applicable to such deductions (such as the separate floors) are first applied and, then, the otherwise allowable total amount of itemized deductions is reduced by three percent of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount.

For 2017, the threshold amounts are $261,500 for single taxpayers, $287,650 for heads of household, $313,800 for married couples filing jointly, and $156,900 for married taxpayers filing separately. These threshold amounts are indexed for inflation. The otherwise allowable itemized deductions may not be reduced by more than 80 percent by reason of the overall limit on itemized deductions.

Description of Proposal

The proposal repeals the overall limitation on itemized deductions.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Modification of deduction for home mortgage interest

Present Law

Deductibility of home mortgage interest

As a general matter, personal interest is not deductible.[95] Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations.[96] Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

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[94] Sec. 68.

[95] Sec. 163(h)(1).

[96] Sec. 163(h)(2)(D) and (h)(3).

Acquisition indebtedness

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing or substantially improving a qualified residence of the taxpayer and which secures the residence. The maximum amount treated as acquisition indebtedness is $1 million ($500,000 in the case of a married person filing a separate return).

Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness. Thus, for example, if the taxpayer incurs $200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to $150,000, the taxpayer's acquisition indebtedness with respect to the residence cannot thereafter be increased above $150,000 (except by indebtedness incurred to substantially improve the residence).

Interest on acquisition indebtedness is allowable in computing alternative minimum taxable income. However, in the case of a second residence, the acquisition indebtedness may only be incurred with respect to a house, apartment, condominium, or a mobile home that is not used on a transient basis.

Home equity indebtedness

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence.

The amount of home equity indebtedness may not exceed $100,000 ($50,000 in the case of a married individual filing a separate return) and may not exceed the fair market value of the residence reduced by the acquisition indebtedness.

Interest on home equity indebtedness is not deductible in computing alternative minimum taxable income.

Interest on qualifying home equity indebtedness is deductible, regardless of how the proceeds of the indebtedness are used. For example, personal expenditures may include health costs and education expenses for the taxpayer's family members or any other personal expenses such as vacations, furniture, or automobiles. A taxpayer and a mortgage company can contract for the home equity indebtedness loan proceeds to be transferred to the taxpayer in a lump sum payment (e.g., a traditional mortgage), a series of payments (*e.g.*, a reverse mortgage), or the lender may extend the borrower a line of credit up to a fixed limit over the term of the loan (*e.g.*, a home equity line of credit).

Thus, the aggregate limitation on the total amount of a taxpayer's acquisition indebtedness and home equity indebtedness with respect to a taxpayer's principal residence and a second residence that may give rise to deductible interest is $1,100,000 ($550,000, for married persons filing a separate return).

Description of Proposal

The proposal modifies the home mortgage interest deduction in the following ways. First, under the proposal, only interest paid on indebtedness used to acquire, construct or substantially improve the taxpayer's principal residence may be included in the calculation of the credit. Thus, under the proposal a taxpayer receives no credit for interest paid on indebtedness used to acquire a second home.

Second, under the proposal, a taxpayer may treat no more than $500,000 as principal residence acquisition indebtedness ($250,000 in the case of married taxpayers filing separately). In the case of principal residence acquisition indebtedness incurred before the date of introduction (November 2, 2017), this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately).[97]

Last, under the proposal, interest paid on home equity indebtedness incurred after 2017 is not treated as qualified residence interest, and thus is not deductible.

Effective Date

The proposal is effective for interest paid or accrued in taxable years beginning after December 31, 2017.

3. Modification of deduction for taxes not paid or accrued in a trade or business

Present Law

Individuals are permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes are: (i) State, local real and foreign property taxes;[98] (ii) State and local personal property taxes;[99] (iii) State, local and foreign income, war profits, and excess profits taxes.[100] At the election of the taxpayer, an itemized

97 Special rules apply in the case of indebtedness from refinancing existing principal residence acquisition indebtedness. Specifically, the $1,000,000 ($500,000 in the case of married taxpayers filing separately) limitation continues to apply to any indebtedness incurred on or after November 2, 2017, to refinance qualified residence indebtedness incurred before that date to the extent the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness. Thus, the maximum dollar amount that may be treated as principal residence acquisition indebtedness will not decrease by reason of a refinancing.

98 Sec. 164(a)(1).

99 Sec. 164(a)(2).

100 Sec. 164(a)(3). A foreign tax credit, in lieu of a deduction, is allowable for foreign taxes if the taxpayer so elects.

deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes.[101]

Property taxes may be allowed as a deduction in computing adjusted gross income if incurred in connection with property used in a trade or business; otherwise they are an itemized deduction. In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.[102]

Individuals also are permitted a deduction for Federal and State generation skipping transfer tax ("GST tax") imposed on certain income distributions that are included in the gross income of the distributee.[103]

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.

Description of Proposal

The proposal provides the following in the case of an individual:

State, local and foreign taxes paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income) remain deductible as under present law. In the case of other State and local real property taxes, the proposal limits the deduction to $10,000 ($5,000 in the case of a married person filing a separate return). Other foreign real property taxes and state and local personal property taxes are no longer allowed as a deduction.

State and local income, war profits, and excess profits taxes paid or accrued, other than those paid or accrued in carrying on a trade or business or an activity described in section 212, are no longer allowed as an itemized deduction. The election to deduct State and local sales tax in lieu of State and local income taxes is repealed.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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[101] Sec. 164(b)(5).

[102] See H. Rep. No. 1365 to accompany Individual Income Tax Bill of 1944 (78th Cong., 2d. Sess.), reprinted at 19 C.B. 839 (1944).

[103] Sec. 164(a)(4).

4. Repeal of deduction for personal casualty and theft losses

Present Law

A taxpayer may generally claim a deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft.[104] Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.

Description of Proposal

The proposal repeals the deduction for personal casualty and theft losses. However, notwithstanding the repeal of the deduction, the proposal retains the benefit of the deduction, as modified by the Disaster Tax Relief and Airport and Airway Extension Act of 2017[105] for those individuals who sustained a personal casualty loss arising from hurricanes Harvey, Irma or Maria.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

5. Limitation on wagering losses

Present Law

Losses sustained during the taxable year on wagering transactions are allowed as a deduction only to the extent of the gains during the taxable year from such transactions.[106]

Description of Proposal

The proposal clarifies the scope of "losses from wagering transactions" as that term is used in section 165(d). The proposal provides that this term includes any deduction otherwise allowable under chapter 1 of the Code incurred in carrying on any wagering transaction.

The proposal is intended to clarify that the limitation on losses from wagering transactions applies not only to the actual costs of wagers incurred by an individual, but to other expenses incurred by the individual in connection with the conduct of that individual's gambling

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[104] Sec. 165(c).

[105] Pub. L. No. 115-63.

[106] Sec. 165(d).

activity.[107] The proposal clarifies, for instance, an individual's otherwise deductible expenses in traveling to or from a casino are subject to the limitation under section 165(d).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

6. Modifications to the deduction for charitable contributions

Present Law

In general

The Internal Revenue Code allows taxpayers to reduce their income tax liability by taking deductions for contributions to certain organizations, including charities, Federal, State, local and Indian tribal governments, and certain other organizations.

To be deductible, a charitable contribution generally must meet several threshold requirements. First, the recipient of the transfer must be eligible to receive charitable contributions (*i.e.*, an organization or entity described in section 170(c)). Second, the transfer must be made with gratuitous intent and without the expectation of a benefit of substantial economic value in return. Third, the transfer must be complete and generally must be a transfer of a donor's entire interest in the contributed property (*i.e.*, not a contingent or partial interest contribution). To qualify for a current year charitable deduction, payment of the contribution must be made within the taxable year.[108] Fourth, the transfer must be of money or property—contributions of services are not deductible.[109] Finally, the transfer must be substantiated and in the proper form.

As also discussed below, special rules limit a taxpayer's charitable contributions in a given year to a percentage of income, and those rules, in part, turn on whether the organization receiving the contributions is a public charity or a private foundation. Other special rules determine the deductible value of contributed property for each type of property.

[107] The proposal thus reverses the result reached by the Tax Court in *Ronald A. Mayo v. Commissioner*, 136 T.C. 81 (2011). In that case, the Court held that a taxpayer's expenses incurred in the conduct of the trade or business of gambling, other than the cost of wagers, were not limited by sec. 165(d), and were thus deductible under sec. 162(a).

[108] Sec. 170(a)(1).

[109] For example, as discussed in greater detail below, the value of time spent volunteering for a charitable organization is not deductible. Incidental expenses such as mileage, supplies, or other expenses incurred while volunteering for a charitable organization, however, may be deductible.

Contributions of partial interests in property

In general

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration.[110] This rule of nondeductibility, often referred to as the partial interest rule, generally prohibits a charitable deduction for contributions of income interests, remainder interests, or rights to use property.

A charitable contribution deduction generally is not allowable for a contribution of a future interest in tangible personal property.[111] For this purpose, a future interest is one "in which a donor purports to give tangible personal property to a charitable organization, but has an understanding, arrangement, agreement, etc., whether written or oral, with the charitable organization that has the effect of reserving to, or retaining in, such donor a right to the use, possession, or enjoyment of the property."[112]

A gift of an undivided portion of a donor's entire interest in property generally is not treated as a nondeductible gift of a partial interest in property.[113] For this purpose, an undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property.[114] A gift generally is treated as a gift of an undivided portion of a donor's entire interest in property if the donee is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property.[115]

Other exceptions to the partial interest rule are provided for, among other interests: (1) remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds; (2) present interests in the form of a guaranteed annuity or a fixed

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[110] Secs. 170(f)(3)(A) (income tax), 2055(e)(2) (estate tax), and 2522(c)(2) (gift tax).

[111] Sec. 170(a)(3).

[112] Treas. Reg. sec. 1.170A-5(a)(4). Treasury regulations provide that section 170(a)(3), which generally denies a deduction for a contribution of a future interest in tangible personal property, has "no application in respect of a transfer of an undivided present interest in property. For example, a contribution of an undivided one-quarter interest in a painting with respect to which the donee is entitled to possession during three months of each year shall be treated as made upon the receipt by the donee of a formally executed and acknowledged deed of gift. However, the period of initial possession by the donee may not be deferred in time for more than one year." Treas. Reg. sec. 1.170A-5(a)(2).

[113] Sec. 170(f)(3)(B)(ii).

[114] Treas. Reg. sec. 1.170A-7(b)(1).

[115] Treas. Reg. sec. 1.170A-7(b)(1).

percentage of the annual value of the property; (3) a remainder interest in a personal residence or farm; and (4) qualified conservation contributions.

Qualified conservation contributions

Qualified conservation contributions are not subject to the partial interest rule, which generally bars deductions for charitable contributions of partial interests in property.[116] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property (generally, a conservation easement). Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Percentage limits on charitable contributions

Individual taxpayers

Charitable contributions by individual taxpayers are limited to a specified percentage of the individual's contribution base. The contribution base is the taxpayer's adjusted gross income ("AGI") for a taxable year, disregarding any net operating loss carryback to the year under section 172.[117] In general, more favorable (higher) percentage limits apply to contributions of cash and ordinary income property than to contributions of capital gain property. More favorable limits also generally apply to contributions to public charities (and certain operating foundations) than to contributions to nonoperating private foundations.

More specifically, the deduction for charitable contributions by an individual taxpayer of cash and property that is not appreciated to a charitable organization described in section 170(b)(1)(A) (public charities, private foundations other than nonoperating private foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations generally may be deducted up to the lesser of 30 percent of the taxpayer's contribution base or the excess of (i) 50 percent of the contribution base over (ii) the amount of contributions subject to the 50 percent limitation.

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[116] Secs. 170(f)(3)(B)(iii) and 170(h).

[117] Sec. 170(b)(1)(G).

Contributions of appreciated capital gain property to public charities and other organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base (after taking into account contributions other than contributions of capital gain property). An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to nonoperating private foundations are deductible up to the lesser of 20 percent of the taxpayer's contribution base or the excess of (i) 30 percent of the contribution base over (ii) the amount of contributions subject to the 30 percent limitation.

Finally, more favorable percentage limits sometimes apply to contributions to the donee charity than to contributions that are for the use of the donee charity. Contributions of capital gain property for the use of public charities and other organizations described in section 170(b)(1)(A) also are limited to 20 percent of the taxpayer's contribution base. In contrast to property contributed directly to a charitable organization, property contributed for the use of an organization generally has been interpreted to mean property contributed in trust for the organization.[118] Charitable contributions of income interests (where deductible) also generally are treated as contributions for the use of the donee organization.

Table 2.–Charitable Contribution Percentage Limits For Individual Taxpayers[119]

	Ordinary Income Property and Cash	Capital Gain Property to the Recipient[120]	Capital Gain Property for the use of the Recipient
Public Charities, Private Operating Foundations, and Private Distributing Foundations	50%	30%[121]	20%
Nonoperating Private Foundations	30%	20%	20%

[118] *Rockefeller v. Commissioner*, 676 F.2d 35, 39 (2d Cir. 1982).

[119] Percentages shown are the percentage of an individual's contribution base.

[120] Capital gain property contributed to public charities, private operating foundations, or private distributing foundations will be subject to the 50-percent limitation if the donor elects to reduce the fair market value of the property by the amount that would have been long-term capital gain if the property had been sold.

[121] Certain qualified conservation contributions to public charities (generally, conservation easements), qualify for more generous contribution limits. In general, the 30-percent limit applicable to contributions of capital gain property is increased to 100 percent if the individual making the qualified conservation contribution is a qualified farmer or rancher or to 50 percent if the individual is not a qualified farmer or rancher.

Corporate taxpayers

A corporation generally may deduct charitable contributions up to 10 percent of the corporation's taxable income for the year.[122] For this purpose, taxable income is determined without regard to: (1) the charitable contributions deduction; (2) any net operating loss carryback to the taxable year; (3) deductions for dividends received; (4) deductions for dividends paid on certain preferred stock of public utilities; and (5) any capital loss carryback to the taxable year.[123]

Carryforwards of excess contributions

Charitable contributions that exceed the applicable percentage limit generally may be carried forward for up to five years.[124] In general, contributions carried over from a prior year are taken into account after contributions for the current year that are subject to the same percentage limit. Excess contributions made for the use of (rather than to) an organization generally may not be carried forward.

Qualified conservation contributions

Preferential percentage limits and carryforward rules apply for qualified conservation contributions.[125] In general, the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions. Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) (generally, public charities) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry forward any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years. In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable

[122] Sec. 170(b)(2)(A).

[123] Sec. 170(b)(2)(C).

[124] Sec. 170(d).

[125] Sec. 170(b)(1)(E).

charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[126]

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Valuation of charitable contributions

In general

For purposes of the income tax charitable deduction, the value of property contributed to charity may be limited to the fair market value of the property, the donor's tax basis in the property, or in some cases a different amount.

Charitable contributions of cash are deductible in the amount contributed, subject to the percentage limits discussed above. In addition, a taxpayer generally may deduct the full fair market value of long-term capital gain property contributed to charity.[127] Contributions of tangible personal property also generally are deductible at fair market value if the use by the recipient charitable organization is related to its tax-exempt purpose.

In certain other cases, however, section 170(e) limits the deductible value of the contribution of appreciated property to the donor's tax basis in the property. This limitation of the property's deductible value to basis generally applies, for example, for: (1) contributions of inventory or other ordinary income or short-term capital gain property;[128] (2) contributions of tangible personal property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose;[129] and (3) contributions to or for the use of a private foundation (other than certain private operating foundations).[130]

For contributions of qualified appreciated stock, the above-described rule that limits the value of property contributed to or for the use of a private nonoperating foundation to the taxpayer's basis in the property does not apply; therefore, subject to certain limits, contributions of qualified appreciated stock to a nonoperating private foundation may be deducted at fair

[126] Sec. 170(b)(2)(B).

[127] Capital gain property means any capital asset or property used in the taxpayer's trade or business, the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Sec. 170(e)(1)(A).

[128] Sec. 170(e). Special rules, discussed below, apply for certain contributions of inventory and other property.

[129] Sec. 170(e)(1)(B)(i)(I).

[130] Sec. 170(e)(1)(B)(ii). Certain contributions of patents or other intellectual property also generally are limited to the donor's basis in the property. Sec. 170(e)(1)(B)(iii). However, a special rule permits additional charitable deductions beyond the donor's tax basis in certain situations.

market value.[131] Qualified appreciated stock is stock that is capital gain property and for which (as of the date of the contribution) market quotations are readily available on an established securities market.[132] A contribution of qualified appreciated stock (when increased by the aggregate amount of all prior such contributions by the donor of stock in the corporation) generally does not include a contribution of stock to the extent the amount of the stock contributed exceeds 10 percent (in value) of all of the outstanding stock of the corporation.[133]

Contributions of property with a fair market value that is less than the donor's tax basis generally are deductible at the fair market value of the property.

Enhanced deduction rules for certain contributions of inventory and other property

Although most charitable contributions of property are valued at fair market value or the donor's tax basis in the property, certain statutorily described contributions of appreciated inventory and other property qualify for an enhanced deduction valuation that exceeds the donor's tax basis in the property, but which is less than the fair market value of the property.

As discussed above, a taxpayer's deduction for charitable contributions of inventory property generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less, the fair market value of the property. For certain contributions of inventory, however, C corporations (but not other taxpayers) may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (*i.e.*, basis plus one-half of fair market value in excess of basis) or (2) two times basis.[134] To be eligible for the enhanced deduction value, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[135] Contributions to organizations that are not described in section 501(c)(3), such as governmental entities, do not qualify for this enhanced deduction.

To use the enhanced deduction provision, the taxpayer must establish that the fair market value of the donated item exceeds basis.

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[131] Sec. 170(e)(5).

[132] Sec. 170(e)(5)(B).

[133] Sec. 170(e)(5)(C).

[134] Sec. 170(e)(3).

[135] Sec. 170(e)(3)(A)(i)-(iii).

A taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for certain donations of food inventory.[136]

Selected statutory rules for specific types of contributions

Special statutory rules limit the deductible value (and impose enhanced reporting obligations on donors) of charitable contributions of certain types of property, including vehicles, intellectual property, and clothing and household items. Each of these rules was enacted in response to concerns that some taxpayers did not accurately report – and in many instances overstated – the value of the property for purposes of claiming a charitable deduction.

Vehicle donationss.−Under present law, the amount of deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeds $500 and excluding inventory property) depends upon the use of the vehicle by the donee organization. If the donee organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction may not exceed the gross proceeds received from the sale. In other situations, a fair market value deduction may be allowed.

Patents and other intellectual property.−If a taxpayer contributes a patent or other intellectual property (other than certain copyrights or inventory)[137] to a charitable organization, the taxpayer's initial charitable deduction is limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property.[138] In addition, the taxpayer generally is permitted to deduct, as a charitable contribution, certain additional amounts in the year of contribution or in subsequent taxable years based on a specified percentage of the qualified donee income received or accrued by the charitable donee with respect to the contributed intellectual property. For this purpose, qualified donee income includes net income received or accrued by the donee that properly is allocable to the intellectual property itself (as opposed to the activity in which the intellectual property is used).[139]

Clothing and household items.−Charitable contributions of clothing and household items generally are subject to the charitable deduction rules applicable to tangible personal property. If such contributed property is appreciated property in the hands of the taxpayer, and is not used to further the donee's exempt purpose, the deduction is limited to basis. In most situations,

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[136] Sec. 170(e)(3)(C).

[137] Under present and prior law, certain copyrights are not considered capital assets, such that the charitable deduction for such copyrights generally is limited to the taxpayer's basis. See sec. 1221(a)(3), 1231(b)(1)(C).

[138] Sec. 170(e)(1)(B)(iii).

[139] The present-law rules allowing additional charitable deductions for qualified donee income were enacted as part of the American Jobs Creation Act of 2004, and are effective for contributions made after June 3, 2004. For a more detailed description of these rules, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS-5-05), May 2005, pp. 457-461.

however, clothing and household items have a fair market value that is less than the taxpayer's basis in the property. Because property with a fair market value less than basis generally is deductible at the property's fair market value, taxpayers generally may deduct only the fair market value of most contributions of clothing or household items, regardless of whether the property is used for exempt or unrelated purposes by the donee organization. Furthermore, a special rule generally provides that no deduction is allowed for a charitable contribution of clothing or a household item unless the item is in good used or better condition. The Secretary is authorized to deny by regulation a deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and used undergarments. Notwithstanding the general rule, a charitable contribution of clothing or household items not in good used or better condition with a claimed value of more than $500 may be deducted if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property.[140] Household items include furniture, furnishings, electronics, appliances, linens, and other similar items. Food, paintings, antiques, and other objects of art, jewelry and gems, and certain collections are excluded from the special rules described in the preceding paragraph.[141]

College athletic seating rights.−In general, where a taxpayer receives or expects to receive a substantial return benefit for a payment to charity, the payment is not deductible as a charitable contribution. However, special rules apply to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. Specifically, the payor may treat 80 percent of a payment as a charitable contribution where: (1) the amount is paid to or for the benefit of an institution of higher education (as defined in section 3304(f)) described in section (b)(1)(A)(ii) (generally, a school with a regular faculty and curriculum and meeting certain other requirements), and (2) such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.[142]

Use of a vehicle when volunteering for a charity

Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization − such as out-of-pocket transportation expenses necessarily incurred in performing donated services − may qualify as a charitable contribution.[143] No charitable contribution deduction is allowed for traveling expenses (including expenses for meals

[140] As is discussed above, the charitable contribution substantiation rules generally require a qualified appraisal where the claimed value of a contribution is more than $5,000.

[141] The special rules concerning the deductibility of clothing and household items were enacted as part of the Pension Protection Act of 2006, P.L. 109-280 (August 17, 2006), and are effective for contributions made after August 17, 2006. For a more detailed description of these rules, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 109th Congress* (JCS-1-07), January 17, 2007, pp. 597-600.

[142] Sec. 170(l).

[143] Treas. Reg. sec. 1.170A-1(g).

and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.[144]

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may track and deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile.[145] The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.[146]

Substantiation and other formal requirements

In general

A donor who claims a deduction for a charitable contribution must maintain reliable written records regarding the contribution, regardless of the value or amount of such contribution.[147] In the case of a charitable contribution of money, regardless of the amount, applicable recordkeeping requirements are satisfied only if the donor maintains as a record of the contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution. In such cases, the recordkeeping requirements may not be satisfied by maintaining other written records.

No charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution

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[144] Sec. 170(j).

[145] Sec. 170(i).

[146] In lieu of actual operating expenses, an optional standard mileage rate may be used in computing deductible transportation expenses for medical purposes (section 213) or for work-related moving (section 217). The standard mileage rates for medical and moving purposes generally cover only out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile. Such rates do not include costs that are not deductible for medical or moving purposes, such as general maintenance expenses, depreciation, insurance, and registration fees. The medical and moving standard mileage rates are determined by the IRS and updated periodically. For expenses paid or incurred on or after January 1, 2017, the rate for both such purposes is 17 cents per mile. IRS Notice 2016-79.

[147] Sec. 170(f)(17).

from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[148]

In addition, any charity receiving a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services is deductible as a charitable contribution.[149]

If the total charitable deduction claimed for noncash property is more than $500, the taxpayer must attach a completed Form 8283 (Noncash Charitable Contributions) to the taxpayer's return or the deduction is not allowed.[150] In general, taxpayers are required to obtain a qualified appraisal for donated property with a value of more than $5,000, and to attach an appraisal summary to the tax return.

<u>Exception for certain contributions reported by the donee organization</u>

Subsection 170(f)(8)(D) provides an exception to the contemporaneous written acknowledgment requirement described above. Under the exception, a contemporaneous written acknowledgment is not required if the donee organization files a return, on such form and in accordance with such regulations as the Secretary may prescribe, that includes the same content. "[T]he section 170(f)(8)(D) exception is not available unless and until the Treasury Department and the IRS issue final regulations prescribing the method by which donee reporting may be accomplished."[151] No such final regulations have been issued.[152]

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[148] Such acknowledgement must include the amount of cash and a description (but not value) of any property other than cash contributed, whether the donee provided any goods or services in consideration for the contribution, and a good faith estimate of the value of any such goods or services. Sec. 170(f)(8).

[149] Sec. 6115.

[150] Sec. 170(f)(11).

[151] See IRS, Notice of Proposed Rulemaking, Substantiation Requirement for Certain Contributions, REG-138344-13 (October 13, 2015), I.R.B. 2015-41 (preamble).

[152] In October 2015, the IRS issued proposed regulations that, if finalized, would have implemented the section 170(f)(8)(D) exception to the contemporaneous written acknowledgment requirement. The proposed regulations provided that a return filed by a donee organization under section 170(f)(8)(D) must include, in addition to the information generally required on a contemporaneous written acknowledgment: (1) the name and address of the donee organization; (2) the name and address of the donor; and (3) the taxpayer identification number of the donor. In addition, the return must be filed with the IRS (with a copy provided to the donor) on or before February 28 of the year following the calendar year in which the contribution was made. Under the proposed regulations, donee reporting would have been optional and would have been available solely at the discretion of the donee organization. The proposed regulations were withdrawn in January 2016. See Prop. Treas. Reg. sec 1.170A-13(f)(18).

Description of Proposal

The proposal makes the following modifications to the present law charitable deduction rules.

Increased percentage limits for contributions of cash to public charities

The proposal increases the income-based percentage limit described in section 170(b)(1)(A) for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent.

Charitable mileage rate adjusted for inflation

The proposal repeals the statutory charitable mileage rate and provides instead that the standard mileage rate used for determining the charitable contribution deduction shall be a rate which takes into account the variable costs of operating an automobile. The intent of the provision is to allow the IRS to determine, and make periodic adjustments to, the charitable standard mileage rate, taking into account the types of costs that are deductible under section 170 of the Code when operating a vehicle in connection with providing volunteer services (*i.e.*, generally, the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile for such purposes).

Denial of deduction for college athletic event seating rights

The proposal amends section 170(l) to provide that no charitable deduction shall be allowed for any amount described in paragraph 170(l)(2), generally, a payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event, as described in greater detail above.

Repeal of substantiation exception for certain contributions reported by the donee organization

The provision repeals the section 170(f)(8)(D) exception to the contemporaneous written acknowledgment requirement.

Effective Date

The proposal is effective for contributions made in taxable years beginning after December 31, 2017.

7. Repeal of deduction for tax preparation expenses

Present Law

For regular income tax purposes, individuals are allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for

the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.[153]

Description of Proposal

The proposal repeals the deduction for expenses in connection with the determination, collection, or refund of any tax.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

8. Repeal of deduction for medical expenses

Present Law

Individuals may claim an itemized deduction for unreimbursed medical expenses, but only to the extent that such expenses exceed 10 percent of adjusted gross income.[154] For taxable years beginning before January 1, 2017, the 10-percent threshold is reduced to 7.5 percent in the case of taxpayers who have attained the age of 65 before the close of the taxable year. In the case of married taxpayers, the 7.5 percent threshold applies if either spouse has obtained the age of 65 before the close of the taxable year. For these taxpayers, during these years, the threshold is 10 percent for AMT purposes.

Description of Proposal

The proposal repeals the deduction for unreimbursed medical expenses.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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[153] Sec. 212.

[154] Sec. 213. The threshold was amended by the Patient Protection and Affordable Care Act (Pub. L. No. 111-118). For taxable years beginning before January 1, 2013, the threshold was 7.5 percent and 10 percent for alternative minimum tax ("AMT") purposes.

9. Repeal of deduction for alimony payments and corresponding inclusion in gross income

Present Law

Alimony and separate maintenance payments are deductible by the payor spouse and includible in income by the recipient spouse.[155] Child support payments are not treated as alimony.[156]

Description of Proposal

Under the proposal, alimony and separate maintenance payments are not deductible by the payor spouse. The proposal repeals sections 61(a)(8) and 71 of the Code. These sections specify that alimony and separate maintenance payments are included in income. Thus, the intent of the proposal is to follow the rule of the Supreme Court's holding in *Gould v. Gould*,[157] in which the Court held that such payments are not income to the recipient. The treatment of child support is not changed.

Effective Date

The proposal is effective for any divorce or separation instrument executed after December 31, 2017, or for any divorce or separation instrument executed on or before December 31, 2017, and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification.

10. Repeal of deduction for moving expenses

Present Law

Individuals are permitted an itemized deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.[158] Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

Description of Proposal

The proposal repeals the deduction for moving expenses.

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[155] Secs. 215(a) and 71(a).

[156] Sec. 71(c).

[157] 245 U.S. 151 (1917).

[158] Sec. 217(a).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

11. Termination of deduction and exclusions for contributions to medical savings accounts

Present Law

Archer MSAs

As of 1997, certain individuals are permitted to contribute to an Archer MSA, which is a tax-exempt trust or custodial account.[159] Within limits, contributions to an Archer MSA are deductible in determining adjusted gross income if made by an individual and are excludible from gross income for income tax purposes and wages for employment tax[160] purposes if made by the employer of an individual.[161]

An individual is generally eligible for an Archer MSA if the individual is covered by a high deductible health plan and no other health plan other than a plan that provides certain permitted insurance or permitted coverage. In addition, the individual either must be an employee of a small employer (generally an employer with 50 or fewer employees on average) that provides the high deductible health plan or must be self-employed or the spouse of a self-employed individual and the high deductible health plan is not provided by the employer of the individual or spouse.

For 2017, a high deductible health plan for purposes of Archer MSA eligibility is a health plan with an annual deductible of at least $2,250 and not more than $3,350 in the case of self-only coverage and at least $4,500 and not more than $6,750 in the case of family coverage. In addition, for 2017, the maximum out-of-pocket expenses with respect to allowed costs must be no more than $4,500 in the case of self-only coverage and no more than $8,250 in the case of family coverage. Out-of-pocket expenses include deductibles, co-payments, and other amounts (other than premiums) that the individual must pay for covered benefits under the plan. A plan does not fail to qualify as a high deductible health plan if substantially all of the coverage under the plan is certain permitted insurance or is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

The maximum annual contribution that can be made to an Archer MSA for a year is 65 percent of the annual deductible under the individual's high deductible health plan in the case of self-only coverage (65 percent of $3,350 for 2017) and 75 percent of the annual deductible in the case of family coverage (75 percent of $6,750 for 2017), but in no case more than the individual's compensation income. In addition, the maximum contribution can be made only if the individual is covered by the high deductible health plan for the full year.

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[159] Archer MSAs were originally called medical savings accounts or MSAs.

[160] The FICA exclusion is provided under IRS Notice 96-53.

[161] Secs. 106(b) and 220.

Distributions from an Archer MSA for qualified medical expenses are not includible in gross income. Distributions not used for qualified medical expenses are includible in gross income and subject to an additional 20-percent tax unless an exception applies. A distribution from an Archer MSA may be rolled over on a nontaxable basis to another Archer MSA or to a health savings account and does not count against the contribution limits.

After 2007, no new contributions can be made to Archer MSAs except by or on behalf of individuals who previously had made Archer MSA contributions and employees of small employers that previously contributed to Archer MSAs (or at least 20 percent of whose employees who were previously eligible to contribute to Archer MSAs did so).

Health savings accounts

As of 2004, an individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) generally may contribute to a health savings account ("HSA"), which is a tax-exempt trust or custodial account. HSAs provide similar tax-favored savings treatment as Archer MSAs. That is, within limits, contributions to an HSA are deductible in determining adjusted gross income if made by an individual and are excludable from gross income for income tax purposes and wages for employment tax[162] purposes if made by the employer of an individual, and distributions for qualified medical expenses are not includible in gross income.[163] However, the rules for HSAs are in various aspects more favorable than the rules for Archer MSAs. For example, the availability of HSAs is not limited to employees of small employers or self-employed individuals and their spouses.

For 2017, a high deductible health plan for purposes of HSA eligibility is a health plan with an annual deductible of at least $1,300 in the case of self-only coverage and at least $2,600 in the case of family coverage. In addition, for 2017, the sum of the deductible and the maximum out-of-pocket expenses with respect to allowed costs must be no more than $6,550 in the case of self-only coverage and no more than $13,100 in the case of family coverage. A plan does not fail to qualify as a high deductible health plan for HSA purposes merely because it does not have a deductible for preventive care.

For 2017, the maximum aggregate annual contribution that can be made to an HSA is $3,400 in the case of self-only coverage and $6,750 in the case of family coverage. The annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up contributions"). The maximum amount that an individual make contribute is reduced by the amount of any contributions to the individual's Archer MSA and any excludable HSA contributions made by the individual's employer. In some cases, an individual may make the maximum HSA contribution, even if the individual is covered by the high deductible health plan for only part of the year. A distribution from an HSA

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162 The FICA exclusion is provided under IRS Notice 2004-2.

163 Secs. 106(d) and 223.

may be rolled over on a nontaxable basis to another HSA and does not count against the contribution limits.

Description of Proposal

Under the proposal, contributions to Archer MSAs for taxable years beginning after December 31, 2017, are not deductible or excludible from gross income and wages.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

12. Denial of deduction for expenses attributable to the trade or business of being an employee, expenses of teachers, performing artists and certain officials

Present Law

In general, business expenses incurred by an employee are deductible, but only as an itemized deduction and only to the extent the expenses exceed two percent of adjusted gross income.[164] However, in the case of certain employees and certain expenses, a deduction may be taken in determining adjusted gross income (referred to as an "above-the-line" deduction), including expenses of qualified performing artists, expenses of State or local government officials performing services on a fee basis, expenses of eligible educators (applicable under present law for taxable years beginning after 2001 and before 2017), and expenses of members of a reserve component of the Armed Forces.[165]

Present law and IRS guidance provide for numerous items that may be deducted under this provision (subject to the two-percent adjusted gross income floor). This non-exhaustive list includes):[166]

- Business bad debt of an employee;
- Business liability insurance premiums;
- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer do his job;
- Dues to professional societies;

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164 Secs. 62(a)(1) and 67.

165 Sec. 62(a)(2)(B), (C), (D) and (E). Under section 62(a)(2)(A) and (c), certain reimbursements of employee business expenses are excluded from income.

166 See IRS Publication 529, "*Miscellaneous Deductions*" (2016), p. 3.

- Educator expenses[167];
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's work;
- Tools and supplies used in the taxpayer's work;
- Travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

A working condition fringe provided to an employee is excluded from the employee's income and wages.[168] For this purpose, a working condition fringe means property or services provided to an employee to the extent that, if the employee paid for the property or service, the payment would be deductible as a business expense or depreciation.

Description of Proposal

Under the proposal, business expenses incurred by an employee are not deductible, other than expenses that are deductible in determining adjusted gross income (that is, above-the-line deductions).

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[167] Under a special provision, these expenses are deductible "above the line" up to $250.

[168] Sec. 132(a)(3) and (d).

In addition, the proposal repeals the provisions allowing above-the-line deductions for expenses of qualified performing artists and expenses of State or local government officials performing services on a fee basis. The proposal also repeals the provision allowing an above-the-line deduction for expenses of eligible educators for taxable years beginning after 2001 and before 2017. The proposal retains the provision allowing an above-the-line deduction for expenses of members of a reserve component of the Armed Forces.[169]

In addition, whether property or services provided by an employer are excluded as a working condition fringe is determined without regard to the proposal. That is, the same standard as under present law applies for this purpose.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

[169] The proposal also retains the provision under which certain reimbursements of employee business expenses are excluded from income.

E. Simplification and Reform of Exclusions and Taxable Compensation

1. Limitation on exclusion for employer-provided housing

Present Law

The value of lodging furnished to an employee, spouse, or dependents by or on behalf of an employer for the convenience of the employer (referred to as "employer-provided lodging") is excludible from the employee's gross income, but only if the employee is required to accept the lodging on the business premises of the employer as a condition of employment.[170] Special rules apply with respect to employees living in foreign camps[171] and lodging furnished by certain educational institutions to employees.[172] Amounts attributable to employer-provided lodging that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

Description of Proposal

The proposal limits the amount that may be excluded from gross income for employer-provided lodging to $50,000 ($25,000 in the case of a married individual filing a separate return), subject to a phase-out based on the employee's level of compensation. The exclusion is phased out by $1 for every $2 earned above the indexed compensation threshold. For 2017, this compensation threshold is $120,000.[173] The proposal also denies any exclusion for employer-provided housing provided to 5% owners,[174] regardless of their compensation level.

In addition, the exclusion does not apply to more than one residence at any given time. In the case of spouses filing a joint return, the one residence limit may be applied separately to each spouse for a period during which the spouses reside in separate residences provided in connection with their respective employments.

Those amounts that are not excludible from gross income for income tax purposes will also not be excluded from wages for employment tax purposes.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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170 Sec. 119(a).

171 Sec. 119(c).

172 Sec. 119(d).

173 The compensation threshold is that amount in effect under section 414(q)(1)(B)(i).

174 As defined in section 416(i)(1)(B)(i).

2. Modification of exclusion of gain on sale of a principal residence

Present Law

A taxpayer who is an individual may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period.

Description of Proposal

The proposal extends the length of time a taxpayer must own and use a residence to qualify for this exclusion. Specifically, the exclusion is available only if the taxpayer has owned and used the residence as a principal residence for at least five of the eight years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the five years that the ownership and use requirements are met.

The proposal limits the exclusion so that the exclusion may not apply to more than one sale or exchange during any five-year period.

The proposal phases-out the exclusion by one dollar for every dollar a taxpayer's AGI exceeds $250,000 ($500,000 if married filing a joint return). For purposes of this provision, AGI is measured using the average of the taxpayers' AGI in the year of sale (excluding any income from the sale of the home) and the prior two taxable years before such sale.

Effective Date

The proposal is effective for sales and exchanges after December 31, 2017.

3. Repeal of exclusion, etc., for employee achievement awards

Present Law

An employer's deduction for the cost of an employee achievement award is limited to a certain amount.[175] Employee achievement awards that are deductible by an employer (or would be deductible but for the fact that the employer is a tax-exempt organization) are excludible from an employee's gross income.[176] Amounts that are excludible from gross income under section 74(c) for income tax purposes are also excluded from wages for employment tax purposes.

An employee achievement award is an item of tangible personal property given to an employee in recognition of either length of service or safety achievement and presented as part of a meaningful presentation.

Description of Proposal

The proposal repeals the deduction limitation for employee achievement awards. It also repeals the exclusions from gross income and wages.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Repeal of exclusion for dependent care assistance programs

Present Law

An exclusion from the gross income of an employee of up to $5,000 annually for employer-provided dependent care assistance[177] is allowed if the assistance is provided pursuant to a separate written plan of an employer that does not discriminate in favor of highly compensated employees[178] and meets certain other requirements. The amount excludible cannot exceed the earned income of the employee or, if the employee is married, the lesser of the earned income of the employee or the earned income of the employee's spouse. Amounts attributable to dependent care assistance that are excludible from gross income for income tax purposes are also excludible from wages for employment tax purposes.

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[175] Sec. 274(j).

[176] Sec. 74(c).

[177] Sec. 129(a).

[178] Sec. 129(d). The exclusion applies if the contributions or benefits under the program do not discriminate in favor of highly compensated employees, within the meaning of sec. 414(q), or their dependents, and the program benefits employees under a classification established by the employer found not to be discriminatory in favor or such highly compensated employees or their dependents.

Description of Proposal

The proposal repeals the exclusions from gross income and wages for dependent care assistance programs.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

5. Repeal of exclusion for qualified moving expense reimbursement

Present Law

Qualified moving expense reimbursements are excludible from an employee's gross income[179], and are defined as any amount received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses under section 217[180] if directly paid or incurred by the employee. However, any such amount actually deducted by the individual is not eligible for this exclusion. Amounts excludible from gross income for income tax purposes as qualified moving expense reimbursements are also excluded from wages for employment tax purposes.

Description of Proposal

The proposal repeals the exclusion from gross income and wages for qualified moving expense reimbursements.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

6. Repeal of exclusion for adoption assistance programs

Present Law

An exclusion from an employee's gross income is allowed for qualified adoption expenses paid or reimbursed by an employer, if such amounts are furnished pursuant to an adoption assistance program.[181] For 2017, the maximum exclusion amount is $13,570, and is phased out ratably for taxpayers with modified adjusted gross income ("AGI") above a certain amount. In 2017, the phase out range begins at modified AGI of $203,540, with no exclusion

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[179] Secs. 132(a)(6) and 132(g).

[180] Individuals are allowed an itemized deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.[180] Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

[181] Sec. 137(a).

when modified AGI equals or exceeds $243,540. Modified AGI is the sum of the taxpayer's AGI plus amounts excluded from income under sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands and residents of Puerto Rico, respectively).

In the case of adoption of a child with special needs that is finalized during a taxable year, the taxpayer may claim as an exclusion the amount of the maximum exclusion minus the aggregate qualified adoption expenses with respect to that adoption for all prior taxable years.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that are: (1) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (2) not incurred in violation of State or Federal law, or in carrying out any surrogate parenting arrangement; (3) not for the adoption of the child of the taxpayer's spouse; and (4) not reimbursed (*e.g.*, by an employer).[182]

For the exclusion to apply, certain requirements must be satisfied, including satisfaction of nondiscrimination rules and providing employees with reasonable notification of the availability and terms of the program.[183]

Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit under section 23. A taxpayer may be eligible for the adoption credit (with respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

Description of Proposal

The proposal repeals the exclusion from gross income for adoption assistance programs.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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[182] Sec. 23(d)(1).

[183] The employer's adoption assistance program must not discriminate in favor of highly compensated employees, within the meaning of sec. 414(q). In addition, no more than five percent of the amounts paid or incurred by the employer during the year for qualified adoption expenses under an adoption assistance program can be provided for the class of individuals consisting of more-than-five-percent owners of the employer and the spouses or dependents of such more-than-five-percent owners.

F. Simplification and Reform of Savings, Pensions, Retirement

1. Repeal of special rule permitting recharacterization of IRA contributions

Present Law

Individual retirement arrangements

There are two basic types of individual retirement arrangements ("IRAs") under present law: traditional IRAs,[184] to which both deductible and nondeductible contributions may be made,[185] and Roth IRAs, to which only nondeductible contributions may be made.[186] The principal difference between these two types of IRAs is the timing of income tax inclusion.

An annual limit applies to contributions to IRAs. The contribution limit is coordinated so that the aggregate maximum amount that can be contributed to all of an individual's IRAs (both traditional and Roth) for a taxable year is the lesser of a certain dollar amount ($5,500 for 2017) or the individual's compensation. In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses is at least equal to the contributed amount. The dollar limit is increased annually ("indexed") as needed to reflect increases in the cost-of living. An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions up to $1,000 to an IRA. The IRA catch-up contribution limit is not indexed.

Traditional IRAs

An individual may make deductible contributions to a traditional IRA up to the IRA contribution limit (reduced by any contributions to Roth IRAs) if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income ("AGI") for the taxable year over certain indexed levels.[187] To the extent an individual cannot or does not make deductible contributions to a traditional IRA or contributions to a Roth IRA for the taxable year, the individual may make nondeductible after-tax contributions to a traditional IRA (that is, no AGI limits apply), subject to the same contribution limits as the limits on deductible contributions, including catch-up contributions. An individual who has attained age 70½ before to the close of a year is not permitted to make contributions to a traditional IRA for that year.

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[184] Sec. 408.

[185] Sec. 219.

[186] Sec. 408A.

[187] Sec. 219(g).

Amounts held in a traditional IRA are includible in income when withdrawn, except to the extent the withdrawal is a return of the individual's basis.[188] All traditional IRAs of an individual are treated as a single contract for purposes of recovering basis in the IRAs.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with AGI for the taxable year over certain indexed levels.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income. A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings; amounts that are attributable to a return of contributions to the Roth IRA are not includible in income. All Roth IRAs are treated as a single contract for purposes of determining the amount that is a return of contributions.

Separation of traditional and Roth IRA accounts

Contributions to traditional IRAs and to Roth IRAs must be segregated into separate IRAs, meaning arrangements with separate trusts, accounts, or contracts, and separate IRA documents. Except in the case of a conversion or recharacterization, amounts cannot be transferred or rolled over between the two types of IRAs.

Taxpayers generally may convert an amount in a traditional IRA to a Roth IRA.[189] The amount converted is includible in the taxpayer's income as if a withdrawal had been made.[190] The conversion is accomplished by a trustee-to-trustee transfer of the amount from the traditional IRA to the Roth IRA, or by a distribution from the traditional IRA and contribution to the Roth IRA within 60 days.

Rollovers to IRAs of distributions from tax-favored employer-sponsored retirement plans (that is, qualified retirement plans, tax-deferred annuity plans, and governmental eligible

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188 Basis results from after-tax contributions to traditional IRAs or a rollovers to traditional IRAs of after-tax amounts from another eligible retirement plan.

189 Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA.

190 Subject to various exceptions, distributions from an IRA before age 59½ that are includible in income are subject to a 10-percent early distribution tax under section 72(t). An exception applies to an amount includible in income as a result of the conversion from a traditional IRA into a Roth IRA. However, the early distribution tax applies if the taxpayer withdraws the amount within five years of the conversion.

deferred compensation plans[191]) are also permitted. For tax-free rollovers, distributions from pretax accounts under an employer-sponsored plan generally must are contributed to a traditional IRA, and distributions from a designated Roth account under an employer-sponsored plan must be contributed only to a Roth IRA. However, a distribution from an employer-sponsored plan that is not from a designated Roth account is also permitted to be rolled over into a Roth IRA, subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus, a rollover from a tax-favored employer-sponsored plan to a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions).[192]

<u>Recharacterization of IRA contributions</u>

If an individual makes a contribution to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date for the individual's income tax return for that year.[193] In the case of a recharacterization, the contribution will be treated as having been made to the transferee IRA (and not the original, transferor IRA) as of the date of the original contribution. Both regular contributions and conversion contributions to a Roth IRA can be recharacterized as having been made to a traditional IRA.

The amount transferred in a recharacterization must be accompanied by any net income allocable to the contribution. In general, even if a recharacterization is accomplished by transferring a specific asset, net income is calculated as a pro rata portion of income on the entire account rather than income allocable to the specific asset transferred. However, when doing a Roth conversion of an amount for a year, an individual may establish multiple Roth IRAs, for example, Roth IRAs with different investment strategies, and divide the amount being converted among the IRAs. The individual can then choose whether to recharacterize any of the Roth IRAs as a traditional IRA by transferring the entire amount in the particular Roth IRA to a traditional IRA.[194] For example, if the value of the assets in a particular Roth IRA declines after the conversion, the conversion can be reversed by recharacterizing that IRA as a traditional IRA. The individual may then later convert that traditional IRA to a Roth IRA (referred to as a reconversion), including only the lower value in income. Treasury regulations prevent the reconversion from taking place immediately after the recharcterization, by requiring a minimum period to elapse before the reconversion. Generally the reconversion cannot occur sooner than

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[191] Secs. 401(a), 403(a), 403(b) and 457(b).

[192] As in the case of a conversion of an amount from a traditional IRA to a Roth IRA, the special recapture rule relating to the 10-percent additional tax on early distributions applies for distributions made from the Roth IRA within a specified five-year period after the rollover.

[193] Sec. 408A(d)(6).

[194] Treas. Reg. sec. 1.408A-5, Q&A-2(b).

the later of 30 days after the recharacterization or a date during the taxable year following the taxable year of the original conversion.[195]

Description of Proposal

The proposal repeals the special rule that allows IRA contributions to one type of IRA (either traditional or Roth) to be recharacterized as a contribution to the other type of IRA. Thus, for example, under the proposal, a conversion contribution establishing a Roth IRA during a taxable year can no longer be recharacterized as a contribution to a traditional IRA (thereby unwinding the conversion).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Reduction in minimum age for allowable in-service distributions

Present Law

Tax-favored employer-sponsored retirement plans consist of qualified retirement plans, including certain defined contribution plans that allow employees to make elective deferrals (a "section 401(k) plan"), tax-deferred annuity plans (a "section 403(b) plan"), which may also allow employees to make elective deferrals, and eligible deferred compensation plans of State and local government employers (a "governmental section 457(b) plan").[196] The terms of an employer-sponsored retirement plan generally determine when distributions are permitted. However, in some cases, restrictions may apply to distribution before an employee's severance from employment, referred to as "in-service" distributions.

In-service distributions of elective deferrals (and related earnings) under a section 401(k) plan generally are permitted only after attainment of age 59½ or termination of the plan.[197] In-service distributions of elective deferrals (but not related earnings) are also permitted in the case of hardship. Elective deferrals under a section 403(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a section 401(k) plan, and, in some cases, other contributions to a section 403(b) plan are subject to similar restrictions.[198]

Pension plans, that is, qualified defined benefit plans and money purchase pension plans, a type of qualified defined contribution plan, generally may not permit in-service distributions

[195] Treas. Reg. sec. 1.408A-5, Q&A-9.

[196] Secs. 401(a), 401(k), 403(a), 403(b), and 457(b).

[197] Sec. 401(k)(2)(B). Similar restrictions apply to certain other contributions, such as employer matching or nonelective contributions required under the nondiscrimination safe harbors under section 401(k).

[198] Secs. 403(b)(7)(A)(ii) and 403(b)(11).

before attainment of age 62 (or attainment of normal retirement age under the plan if earlier) or termination of the plan.[199]

Deferrals under a governmental section 457(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a section 401(k) plan, except that in-service distributions under a governmental section 457(b) plan are permitted only after attainment of age 70½ (rather than age 59½).[200]

Description of Proposal

Under the proposal, in-service distributions are permitted under a pension plan or a governmental section 457(b) plan at age 59½, thus making the rules for those plans consistent with the rules for section 401(k) plans and section 403(b) plans.

Effective Date

The proposal is effective for plan years beginning after December 31, 2017.

3. Modification of rules governing hardship distributions

Present Law

Elective deferrals under a section 401(k) plan or a section 403(b) plan may not be distributed before the occurrence of one or more specified events, including financial hardship of the employee.[201]

Applicable Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.[202] The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective deferrals and employee contributions to the plan and all other plans maintained by the employer for at least six months after receipt of the hardship distribution.

Description of Proposal

The Secretary of the Treasury is directed to modify the applicable regulations within one year of the date of enactment to (1) delete the requirement that an employee be prohibited from making elective deferrals and employee contributions for six months after the receipt of a

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[199] Sec. 401(a)(36) and Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b).

[200] Sec. 457(d)(1)(A).

[201] Secs. 401(k)(2)(B)(i)(IV) and 403(b)(7)(A)(ii) and (b)(11)(B). Other types of contributions may also be subject to this restriction.

[202] Treas. Reg. sec. 1.401(k)-1(d)(3).

hardship distribution in order for the distribution to be deemed necessary to satisfy an immediate and heavy financial need, and (2) make any other modifications necessary to carry out the purposes of the rule allowing elective deferrals to be distributed in the case of hardship. Thus, under the modified regulations, an employee would not be prevented for any period after the receipt of a hardship distribution from continuing to make elective deferrals and employee contributions.

Effective Date

The regulations as revised by the proposal shall apply to plan years beginning after December 31, 2017.

4. Modification of rules relating to hardship withdrawals from cash or deferred arrangements

Present Law

Amounts attributable to elective deferrals (including earnings thereon) under a section 401(k) plan generally may not be distributed before the earliest of the employee's severance from employment, death, disability or attainment of age 59½, or termination of the plan, or as a qualified reservist distribution.[203] Elective deferrals, but not associated earnings, may be distributed on account of hardship.

An employer may make nonelective and matching contributions for employees under a section 401(k) plan. Elective deferrals, and matching contributions and after-tax employee contributions, are subject to special tests ("nondiscrimination tests") to prevent discrimination in favor of highly compensated employees. Nonelective contributions and matching contributions that satisfy certain requirements ("qualified nonelective contributions and qualified matching contributions") may be used to enable the plan to satisfy these nondiscrimination tests. One of the requirements is that these contributions be subject to the same distribution restrictions as elective deferrals, except that these contributions (and associated earnings) are not permitted to be distributed on account of hardship.

Applicable Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.[204] The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of the safe harbor is that the employee represent that the need cannot be satisfied through currently available plan loans. This in effect requires an employee to take any available plan loan before receiving a hardship distribution.

[203] Sec. 401(k)(2)(B)(i).

[204] Treas. Reg. sec. 1.401(k)-1(d)(3).

Description of Proposal

The proposal allows earnings on elective deferrals under a section 401(k) plan, as well as qualified nonelective contributions and qualified matching contributions (and associated earnings), to be distributed on account of hardship. Further, a distribution is not treated as failing to be on account of hardship solely because the employee does not take any available plan loan.

Effective Date

The proposal applies to plan years beginning after December 31, 2017.

5. Extended rollover period for the rollover of plan loan offset amounts in certain cases

Present Law

Taxation of retirement plan distributions

A distribution from a tax-favored employer-sponsored retirement plan (that is, a qualified retirement plan, section 403(b) plan, or a governmental section 457(b) plan) is generally includible in gross income, except in the case of a qualified distribution from a designated Roth account or to the extent the distribution is a recovery of basis under the plan or the distribution is contributed to another such plan or an IRA (referred to as eligible retirement plans) in a tax-free rollover.[205] In the case of a distribution from a retirement plan to an employee under age 59½, the distribution (other than a distribution from a governmental section 457(b) plan) is also subject to a 10-percent early distribution tax unless an exception applies.[206]

A distribution from a tax-favored employer-sponsored retirement plan that is an eligible rollover distribution may be rolled over to an eligible retirement plan.[207] The rollover generally can be achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the eligible retirement plan within 60 days of receiving the distribution ("60-day rollover").

Employer-sponsored retirement plans are required to offer an employee a direct rollover with respect to any eligible rollover distribution before paying the amount to the employee. If an eligible rollover distribution is not directly rolled over to an eligible retirement plan, the taxable portion of the distribution generally is subject to mandatory 20-percent income tax withholding.[208] Employees who do not elect a direct rollover but who roll over eligible distributions within 60 days of receipt also defer tax on the rollover amounts; however, the 20

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[205] Secs. 402(a) and (c), 402A(d), 403(a) and (b), 457(a) and (e)(16).

[206] Sec. 72(t).

[207] Certain distributions are not eligible rollover distributions, such as annuity payments, required minimum distributions, hardship distributions, and loans that are treated as deemed distributions under section 72(p).

[208] Treas. Reg. sec. 1.402(c)-2, Q&A-1(b)(3).

percent withheld will remain taxable unless the employee substitutes funds within the 60-day period.

Plan loans

Employer-sponsored retirement plans may provide loans to employees. Unless the loan satisfies certain requirements in both form and operation, the amount of a retirement plan loan is a deemed distribution from the retirement plan, including that the terms of the loan provide for a repayment period of not more than five years (except for a loan specifically to purchase a home) and for level amortization of loan payments with payments not less frequently than quarterly.[209] Thus, if an employee stops making payments on a loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. A deemed distribution of an unpaid loan balance is generally taxed as though an actual distribution occurred, including being subject to a 10-percent early distribution tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan.

A plan may also provide that, in certain circumstances (for example, if an employee terminates employment), an employee's obligation to repay a loan is accelerated and, if the loan is not repaid, the loan is cancelled and the amount in employee's account balance is offset by the amount of the unpaid loan balance, referred to as a loan offset. A loan offset is treated as an actual distribution from the plan equal to the unpaid loan balance (rather than a deemed distribution), and (unlike a deemed distribution) the amount of the distribution is eligible for tax-free rollover to another eligible retirement plan within 60 days. However, the plan is not required to offer a direct rollover with respect to a plan loan offset amount that is an eligible rollover distribution, and the plan loan offset amount is generally not subject to 20-percent income tax withholding.

Description of Proposal

Under the proposal, the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the taxable year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan). Under the proposal, a qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a section 403(b) plan or a governmental section 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's separation from service, whether due to layoff, cessation of business, termination of employment, or otherwise. As under present law, a loan offset amount under the proposal is the amount by which an employee's account balance under the plan is reduced to repay a loan from the plan.

[209] Sec. 72(p).

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Modification of nondiscrimination rules for certain plans providing benefits or contributions to older, longer service participants

Present Law

In general

Qualified retirement plans are subject to nondiscrimination requirements, under which the group of employees covered by a plan ("plan coverage") and the contributions or benefits provided to employees, including benefits, rights, and features under the plan, must not discriminate in favor of highly compensated employees.[210] The timing of plan amendments must also not have the effect of discriminating significantly in favor of highly compensated employees. In addition, in the case of a defined benefit plan, the plan must benefit at least the lesser of (1) 50 employees and (2) the greater of 40 percent of all employees and two employees (or one employee if the employer has only one employee), referred to as the "minimum participation" requirements.[211] These nondiscrimination requirements are designed to help ensure that qualified retirement plans achieve the goal of retirement security for both lower and higher paid employees.

For nondiscrimination purposes, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of $120,000 (for 2017).[212] Employees who are not highly compensated are referred to as nonhighly compensated employees.

Nondiscriminatory plan coverage

Whether plan coverage of employees is nondiscriminatory is determined by calculating a plan's ratio percentage, that is, the ratio of the percentage of nonhighly compensated employees covered under the plan to the percentage of highly compensated employees covered. For this purpose, certain portions of a defined contribution plan are treated as separate plans to which the plan coverage requirements are applied separately, referred to as mandatory disaggregation.

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[210] Secs. 401(a)(3)-(5) and 410(b). Detailed rules are provided in Treas. Reg. secs. 1.401(a)(4)-1 through -13 and secs. 1.410(b)-2 through -10. In applying the nondiscrimination requirements, certain employees, such as those under age 21 or with less than a year of service, generally may be disregarded. In addition, employees of controlled groups and affiliated service groups under the aggregation rules of section 414(b), (c), (m) and (o) are treated as employed by a single employer.

[211] Sec. 401(a)(26).

[212] Sec. 414(q). At the election of the employer, employees who are highly compensated based on the amount of their compensation may be limited to employees who were among the top 20 percent of employees based on compensation.

Specifically, the following, if provided under a plan, are treated as separate plans: the portion of a plan consisting of employee elective deferrals, the portion consisting of employer matching contributions, the portion consisting of employer nonelective contributions, and the portion consisting of an employee stock ownership plan ("ESOP").[213] Subject to mandatory disaggregation, different qualified retirement plans may otherwise be aggregated and tested together as a single plan, provided that they use the same plan year. The plan determined under these rules for plan coverage purposes generally is also treated as the plan for purposes of applying the other nondiscrimination requirements.

A plan's coverage is nondiscriminatory if the ratio percentage, as determined above, is 70 percent or greater. If a plan's ratio percentage is less than 70 percent, a multi-part test applies, referred to as the average benefit test. First, the plan must meet a "nondiscriminatory classification requirement," that is, it must cover a group of employees that is reasonable and established under objective business criteria and the plan's ratio percentage must be at or above a level specified in the regulations, which varies depending on the percentage of nonhighly compensated employees in the employer's workforce. In addition, the average benefit percentage test must be satisfied.

Under the average benefit percentage test, in general, the average rate of employer-provided contributions or benefit accruals for all nonhighly compensated employees under all plans of the employer must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.[214] In applying the average benefit percentage test, elective deferrals made by employees, as well as employer matching and nonelective contributions, are taken into account. Generally, all plans maintained by the employer are taken into account, including ESOPs, regardless of whether plans use the same plan year.

Under a transition rule applicable in the case of the acquisition or disposition of a business, or portion of a business, or a similar transaction, a plan that satisfied the plan coverage

[213] Elective deferrals are contributions that an employee elects to have made to a defined contribution plan that includes a qualified cash or deferred arrangement (referred to as "section 401(k) plan") rather than receive the same amount as current compensation. Employer matching contributions are contributions made by an employer only if an employee makes elective deferrals or after-tax employee contributions. Employer nonelective contributions are contributions made by an employer regardless of whether an employee makes elective deferrals or after-tax employee contributions. Under section 4975(e)(7), an ESOP is a defined contribution plan, or portion of a defined contribution plan, that is designated as an ESOP and is designed to invest primarily in employer stock.

[214] Contribution and benefit rates are generally determined under the rules for nondiscriminatory contributions or benefit accruals, described below. These rules are generally based on benefit accruals under a defined benefit plan, other than accruals attributable to after-tax employee contributions, and contributions allocated to participants' accounts under a defined contribution plan, other than allocations attributable to after-tax employee contributions. (Under these rules, contributions allocated to a participants accounts are referred to as "allocations," with the related rates referred to as "allocation rates," but "contribution rates" is used herein for convenience.) However, as discussed below, benefit accruals can be converted to actuarially equivalent contributions, and contributions can be converted to actuarially equivalent benefit accruals.

requirements before the transaction is deemed to continue to satisfy them for a period after the transaction, provided coverage under the plan is not significantly changed during that period.[215]

Nondiscriminatory contributions or benefit accruals

In general

There are three general approaches to testing the amount of benefits under qualified retirement plans: (1) design-based safe harbors under which the plan's contribution or benefit accrual formula satisfies certain uniformity standards, (2) a general test, described below, and (3) cross-testing of equivalent contributions or benefit accruals. Employee elective deferrals and employer matching contributions under defined contribution plans are subject to special testing rules and generally are not permitted to be taken into account in determining whether other contributions or benefits are nondiscriminatory.[216]

The nondiscrimination rules allow contributions and benefit accruals to be provided to highly compensated and nonhighly compensated employees at the same percentage of compensation.[217] Thus, the various testing approaches described below are generally applied to the amount of contributions or accruals provided as a percentage of compensation, referred to as a contribution rate or accrual rate. In addition, under the "permitted disparity" rules, in calculating an employee's contribution or accrual rate, credit may be given for the employer paid portion of Social Security taxes or benefits.[218] The permitted disparity rules do not apply in testing whether elective deferrals, matching contributions, or ESOP contributions are nondiscriminatory.

The general test is generally satisfied by measuring the rate of contribution or benefit accrual for each highly compensated employee to determine if the group of employees with the same or higher rate (a "rate" group) is a nondiscriminatory group, using the nondiscriminatory plan coverage standards described above. For this purpose, if the ratio percentage of a rate group is less than 70 percent, a simplified standard applies, which includes disregarding the reasonable classification requirement, but requires satisfaction of the average benefit percentage test.

Cross-testing

Cross-testing involves the conversion of contributions under a defined contribution plan or benefit accruals under a defined benefit plan to actuarially equivalent accruals or contributions, with the resulting equivalencies tested under the general test. However, employee

[215] Sec. 410(b)(6)(C).

[216] Secs. 401(k) and (m), the latter of which applies also to after-tax employee contributions under a defined contribution plan.

[217] For this purpose, under section 401(a)(17), compensation generally is limited to $265,000 per year (for 2016).

[218] See sections 401(a)(5)(C) and (D) and 401(l) and Treas. Reg. section 1. 401(a)(4)-7 and 1.401(l)-1 through -6 for rules for determining the amount of contributions or benefits that can be attributed to the employer-paid portion of Social Security taxes or benefits.

elective deferrals and employer matching contributions under defined contribution plans are not permitted to be taken into account for this purpose, and cross-testing of contributions under a defined contribution plan, or cross-testing of a defined contribution plan aggregated with a defined benefit plan, is permitted only if certain threshold requirements are satisfied.

In order for a defined contribution plan to be tested on an equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan has broadly available allocation rates, that is, each allocation rate under the plan is available to a nondiscriminatory group of employees (disregarding certain permitted additional contributions provided to employees as a replacement for benefits under a frozen defined benefit plan, as discussed below);
- The plan provides allocations that meet prescribed designs under which allocations gradually increase with age or service or are expected to provide a target level of annuity benefit; or
- The plan satisfies a minimum allocation gateway, under which each nonhighly compensated employee has an allocation rate of (a) at least one-third of the highest rate for any highly compensated employee, or (b) if less, at least five percent.

In order for an aggregated defined contribution and defined benefit plan to be tested on an aggregate equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan must be primarily defined benefit in character, that is, for more than fifty percent of the nonhighly compensated employees under the plan, their accrual rate under the defined benefit plan exceeds their equivalent accrual rate under the defined contribution plan;
- The plan consists of broadly available separate defined benefit and defined contribution plans, that is, the defined benefit plan and the defined contribution plan would separately satisfy simplified versions of the minimum coverage and nondiscriminatory amount requirements; or
- The plan satisfies a minimum aggregate allocation gateway, under which each nonhighly compensated employee has an aggregate allocation rate (consisting of allocations under the defined contribution plan and equivalent allocations under the defined benefit plan) of (a) at least one-third of the highest aggregate allocation rate for any nonhighly compensated employee, or (b) if less, at least five percent in the case of a highest nonhighly compensated employee's rate up to 25 percent, increased by one percentage point for each five-percentage-point increment (or portion thereof) above 25 percent, subject to a maximum of 7.5 percent.

<u>Benefits, rights, and features</u>

Each benefit, right, or feature offered under the plan generally must be available to a group of employees that has a ratio percentage that satisfies the minimum coverage requirements, including the reasonable classification requirement if applicable, except that the

average benefit percentage test does not have to be met, even if the ratio percentage is less than 70 percent.

Multiple-employer and section 403(b) plans

A multiple-employer plan generally is a single plan maintained by two or more unrelated employers, that is, employers that are not treated as a single employer under the aggregation rules for related entities.[219] The plan coverage and other nondiscrimination requirements are applied separately to the portions of a multiple-employer plan covering employees of different employers.[220]

Certain tax-exempt charitable organizations may offer their employees a tax-deferred annuity plan ("section 403(b) plan).[221] The nondiscrimination requirements, other than the requirements applicable to elective deferrals, generally apply to section 403(b) plans of private tax-exempt organizations. For purposes of applying the nondiscrimination requirements to a section 403(b) plan, subject to mandatory disaggregation, a qualified retirement plan may be combined with the section 403(b) plan and treated as a single plan.[222] However, a section 403(b) plan and qualified retirement plan may not be treated as a single plan for purposes of applying the nondiscrimination requirements to the qualified retirement plan.

Closed and frozen defined benefit plans

A defined benefit plan may be amended to limit participation in the plan to individuals who are employees as of a certain date. That is, employees hired after that date are not eligible to participate in the plan. Such a plan is sometimes referred to as a "closed" defined benefit plan (that is, closed to new entrants). In such a case, it is common for the employer also to maintain a defined contribution plan and to provide employer matching or nonelective contributions only to employees not covered by the defined benefit plan or at a higher rate to such employees.

Over time, the group of employees continuing to accrue benefits under the defined benefit plan may come to consist more heavily of highly compensated employees, for example, because of greater turnover among nonhighly compensated employees or because increasing compensation causes nonhighly compensated employees to become highly compensated. In that case, the defined benefit plan may have to be combined with the defined contribution plan and tested on a benefit accrual basis. However, under the regulations, if none of the threshold

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[219] Sec. 413(c). Multiple-employer status does not apply if the plan is a multiemployer plan, defined under sec. 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

[220] Treas. Reg. sec. 1.413-2(a)(3)(ii)-(iii).

[221] Sec. 403(b). These plans are available to employers that are tax-exempt under section 501(c)(3), as well as to educational institutions of State or local governments.

[222] Treas. Reg. sec. 1.410(b)-7(f).

conditions is met, testing on a benefits basis may not be available. Notwithstanding the regulations, recent IRS guidance provides relief for a limited period, allowing certain closed defined benefit plans to be aggregated with a defined contribution plan and tested on an aggregate equivalent benefits basis without meeting any of the threshold conditions.[223] When the group of employees continuing to accrue benefits under a closed defined benefit plan consists more heavily of highly compensated employees, the benefits, rights, and features provided under the plan may also fail the tests under the existing nondiscrimination rules.

In some cases, if a defined benefit plan is amended to cease future accruals for all participants, referred to as a "frozen" defined benefit plan, additional contributions to a defined contribution plan may be provided for participants, in particular for older participants, in order to make up in part for the loss of the benefits they expected to earn under the defined benefit plan ("make-whole" contributions). As a practical matter, testing on a benefit accrual basis may be required in that case, but may not be available because the defined contribution plan does not meet any of the threshold conditions.

Description of Proposal

Closed or frozen defined benefit plans

In general

The proposal provides nondiscrimination relief with respect to benefits, rights, and features for a closed class of participants ("closed class"),[224] and with respect to benefit accruals for a closed class, under a defined benefit plan that meets the requirements described below (referred to herein as an "applicable" defined benefit plan). In addition, the proposal treats a closed or frozen applicable defined benefit plan as meeting the minimum participation requirements if the plan met the requirements as of the effective date of the plan amendment by which the plan was closed or frozen.

If a portion of an applicable defined benefit plan eligible for relief under the proposal is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing requirements applicable for the relevant relief as described below, the relevant relief for the spun-off plan will continue with respect to the other employer.

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[223] Notice 2014-5, 2014-2 I.R.B. 276, extended by Notice 2015-28, 2015-14 14 I.R.B. 848, Notice 2016-57, 2016-40 I.R.B. 432, and Notice 2017-45, 2017-38 I.R.B. 232. Proposed regulations revising the nondiscrimination requirements for closed plans were also issued earlier this year, subject to various conditions. 81 Fed. Reg. 4976 (January 29, 2016).

[224] References under the proposal to a closed class of participants and similar references to a closed class include arrangements under which one or more classes of participants are closed, except that one or more classes of participants closed on different dates are not aggregated for purposes of determining the date any such class was closed.

Benefits, rights, or features for a closed class

Under the proposal, an applicable defined benefit plan that provides benefits, rights, or features to a closed class does not fail the nondiscrimination requirements by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if (1) for the plan year as of which the class closes and the two succeeding plan years, the benefits, rights, and features satisfy the nondiscrimination requirements without regard to the relief under the proposal, but taking into account the special testing rules described below,[225] and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits, rights, and features provided to the closed class does not discriminate significantly in favor of highly compensated employees.

For purposes of requirement (1) above, the following special testing rules apply:

- In applying the plan coverage transition rule for business acquisitions, dispositions, and similar transactions, the closing of the class of participants is not treated as a significant change in coverage;
- Two or more plans do not fail to be eligible to be a treated as a single plan solely by reason of having different plan years;[226] and
- Changes in employee population are disregarded to the extent attributable to individuals who become employees or cease to be employees, after the date the class is closed, by reason of a merger, acquisition, divestiture, or similar event.

Benefit accruals for a closed class

Under the proposal, an applicable defined benefit plan that provides benefits to a closed class may be aggregated, that is, treated as a single plan, and tested on a benefit accrual basis with one or more defined contribution plans (without having to satisfy the threshold conditions under present law) if (1) for the plan year as of which the class closes and the two succeeding plan years, the plan satisfies the plan coverage and nondiscrimination requirements without regard to the relief under the proposal, but taking into account the special testing rules described above,[227] and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits provided to the closed class does not discriminate significantly in favor of highly compensated employees.

Under the proposal, defined contribution plans that may be aggregated with an applicable defined benefit plan and treated as a single plan include the portion of one or more defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective

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[225] Other testing options available under present law are also available for this purpose.

[226] This rule applies also for purposes applying the plan coverage and other nondiscrimination requirements to an applicable defined benefit plan and one or more defined contributions that, under the proposal, may be treated as a single plan as described below.

[227] Other testing options available under present law are also available for this purpose.

contributions under a section 403(b) plan. If an applicable defined benefit plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Applicable defined benefit plan

An applicable defined benefit plan to which relief under the proposal applies is a defined benefit plan under which the class was closed (or the plan frozen) before April 5, 2017, or that meets the following alternative conditions: (1) taking into account any predecessor plan, the plan has been in effect for at least five years as of the date the class is closed (or the plan is frozen) and (2) under the plan, during the five-year period preceding that date, (a) for purposes of the relief provided with respect to benefits, rights, and features for a closed class, there has not been a substantial increase in the coverage or value of the benefits, rights, or features, or (b) for purposes of the relief provided with respect to benefit accruals for a closed class or the minimum participation requirements, there has not been a substantial increase in the coverage or benefits under the plan.

For purposes of (2)(a) above, a plan is treated as having a substantial increase in coverage or value of benefits, rights, or features only if, during the applicable five-year period, either the number of participants covered by the benefits, rights, or features on the date the period ends is more than 50 percent greater than the number on the first day of the plan year in which the period began, or the benefits, rights, and features have been modified by one or more plan amendments in such a way that, as of the date the class is closed, the value of the benefits, rights, and features to the closed class as a whole is substantially greater than the value as of the first day of the five-year period, solely as a result of the amendments.

For purposes of (2)(b) above, a plan is treated as having had a substantial increase in coverage or benefits only if, during the applicable five-year period, either the number of participants benefiting under the plan on the date the period ends is more than 50 percent greater than the number of participants on the first day of the plan year in which the period began, or the average benefit provided to participants on the date the period ends is more than 50 percent greater than the average benefit provided on the first day of the plan year in which the period began. In applying this requirement, the average benefit provided to participants under the plan is treated as having remained the same between the two relevant dates if the benefit formula applicable to the participants has not changed between the dates and, if the benefit formula has changed, the average benefit under the plan is considered to have increased by more than 50 percent only if the target normal cost for all participants benefiting under the plan for the plan year in which the five-year period ends exceeds the target normal cost for all such participants for that plan year if determined using the benefit formula in effect for the participants for the first plan year in the five-year period by more than 50 percent.[228] In applying these rules, a

[228] Under the funding requirements applicable to defined benefit plans, target normal cost for a plan year (defined in section 430(b)(1)(A)(i)) is generally the sum of the present value of the benefits expected to be earned under the plan during the plan year plus the amount of plan-related expenses to be paid from plan assets during the plan year. Under the proposal, in applying this average benefit rule to certain defined benefit plans maintained by

multiple-employer plan is treated as a single plan, rather than as separate plans separately covering the employees of each participating employer.

In applying these standards, any increase in coverage or value, or in coverage or benefits, whichever is applicable, is generally disregarded if it is attributable to coverage and value, or coverage and benefits, provided to employees who (1) became participants as a result of a merger, acquisition, or similar event that occurred during the 7-year period preceding the date the class was closed, or (2) became participants by reason of a merger of the plan with another plan that had been in effect for at least five years as of the date of the merger and, in the case of benefits, rights, or features for a closed class, under the merger, the benefits, rights, or features under one plan were conformed to the benefits, rights, or features under the other plan prospectively.

Make-whole contributions under a defined contribution plan

Under the proposal, a defined contribution plan is permitted to be tested on an equivalent benefit accrual basis (without having to satisfy the threshold conditions under present law) if the following requirements are met:

- The plan provides make-whole contributions to a closed class of participants whose accruals under a defined benefit plan have been reduced or ended ("make-whole class");
- For the plan year of the defined contribution plan as of which the make-whole class closes and the two succeeding plan years, the make-whole class satisfies the nondiscriminatory classification requirement under the plan coverage rules, taking into account the special testing rules described above;
- After the date as of which the class was closed, any amendment to the defined contribution plan modifying the make-whole class or the allocations, benefits, rights, and features provided to the make-whole class does not discriminate significantly in favor of highly compensated employees; and
- Either the class was closed before April 5, 2017, or the defined benefit plan is an applicable defined benefit plan under the alternative conditions applicable for purposes of the relief provided with respect to benefit accruals for a closed class.

With respect to one or more defined contribution plans meeting the requirements above, in applying the plan coverage and nondiscrimination requirements, the portion of the plan providing make-whole or other nonelective contributions may also be aggregated and tested on an equivalent benefit accrual basis with the portion of one or more other defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective contributions under a section 403(b) plan. If the plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting

cooperative organizations and charities, referred to as CSEC plans (defined in section 414(y)), which are subject to different funding requirements, the CSEC plan's normal cost under section 433(j)(1)(B) is used instead of target normal cost.

of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Under the proposal, "make-whole contributions" generally means nonelective contributions for each employee in the make-whole class that are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or qualified cash or deferred arrangement under a section 401(k) plan if no change had been made to the defined benefit plan and other plan or arrangement.[229] However, under a special rule, in the case of a defined contribution plan that provides benefits, rights, or features to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated, the plan will not fail to satisfy the nondiscrimination requirements solely by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if the defined contribution plan and defined benefit plan otherwise meet the requirements described above but for the fact that the make-whole contributions under the defined contribution plan are made in whole or in part through matching contributions.

If a portion of a defined contribution plan eligible for relief under the proposal is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing requirements applicable for the relevant relief as described above, the relevant relief for the spun-off plan will continue with respect to the other employer.

Effective Date

The proposal is generally effective on the date of enactment without regard to whether any plan modifications referred to in the proposal are adopted or effective before, on, or after the date of enactment. However, at the election of a plan sponsor, the proposal will apply to plan years beginning after December 31, 2013. For purposes of the proposal, a closed class of participants under a defined benefit plan is treated as being closed before April 5, 2017, if the plan sponsor's intention to create the closed class is reflected in formal written documents and communicated to participants before that date. In addition, a plan does not fail to be eligible for the relief under the proposal solely because (1) in the case of benefits, rights, or features for a closed class under a defined benefit plan, the plan was amended before the date of enactment to eliminate one or more benefits, rights, or features and is further amended after the date of enactment to provide the previously eliminated benefits, rights, or features to a closed class of participants, or (2) in the case of benefit accruals for a closed class under a defined benefit plan or application of the minimum benefit requirements to a closed or frozen defined benefit plan, the plan was amended before the date of the enactment to cease all benefit accruals and is further amended after the date of enactment to provide benefit accruals to a closed class of participants. In either case, the relevant relief applies only if the plan otherwise meets the requirements for the relief, and, in applying the relevant relief, the date the class of participants is closed is the effective date of the later amendment.

[229] For this purpose, consistency is not required with respect to employees who were subject to different benefit formulas under the defined benefit plan.

G. Estate, Gift, and Generation-Skipping Transfer Taxes

1. Increase in estate and gift tax exemption, followed by repeal of estate and generation-skipping transfer taxes and reduction in gift tax rate

Present Law

In general

A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death. A generation-skipping transfer tax generally is imposed on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Income tax rules determine the recipient's tax basis in property acquired from a decedent or by gift. Gifts and bequests generally are excluded from the recipient's gross income.[230]

Common features of the estate, gift and generation-skipping transfer taxes

Unified credit (exemption) and tax rates

Unified credit.–A unified credit is available with respect to taxable transfers by gift and at death.[231] The unified credit offsets tax, computed using the applicable estate and gift tax rates, on a specified amount of transfers, referred to as the applicable exclusion amount, or exemption amount. The exemption amount was set at $5 million for 2011 and is indexed for inflation for later years.[232] For 2017, the inflation-indexed exemption amount is $5.49 million.[233] Exemption used during life to offset taxable gifts reduces the amount of exemption that remains at death to offset the value of a decedent's estate. An election is available under which exemption that is not used by a decedent may be used by the decedent's surviving spouse (exemption portability).

Common tax rate table.–A common tax-rate table with a top marginal tax rate of 40 percent is used to compute gift tax and estate tax. The 40-percent rate applies to transfers in excess of $1 million (to the extent not exempt). Because the exemption amount currently shields

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[230] Sec. 102.

[231] Sec. 2010.

[232] For 2011 and later years, the gift and estate taxes were reunified, meaning that the gift tax exemption amount was increased to equal the estate tax exemption amount.

[233] For 2015, the $5.49 exemption amount results in a unified credit of $2,141,800, after applying the applicable rates set forth in section 2001(c).

the first $5.49 million in gifts and bequests from tax, transfers in excess of the exemption amount generally are subject to tax at the highest marginal rate (40 percent).

Generation-skipping transfer tax exemption and rate.–The generation-skipping transfer tax is a separate tax that can apply in addition to either the gift tax or the estate tax. The tax rate and exemption amount for generation-skipping transfer tax purposes, however, are set by reference to the estate tax rules. Generation-skipping transfer tax is imposed using a flat rate equal to the highest estate tax rate (40 percent). Tax is imposed on cumulative generation-skipping transfers in excess of the generation-skipping transfer tax exemption amount in effect for the year of the transfer. The generation-skipping transfer tax exemption for a given year is equal to the estate tax exemption amount in effect for that year (currently $5.49 million).

Transfers between spouses.–A 100-percent marital deduction generally is permitted for the value of property transferred between spouses.[234] In addition, transfers of "qualified terminable interest property" also are eligible for the marital deduction. Qualified terminable interest property is property: (1) that passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) to which an election under these rules applies. A qualifying income interest for life exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or has the right to use the property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

A marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States. A marital deduction is permitted, however, for property passing to a qualified domestic trust of which the noncitizen surviving spouse is a beneficiary. A qualified domestic trust is a trust that has as its trustee at least one U.S. citizen or U.S. corporation. No corpus may be distributed from a qualified domestic trust unless the U.S. trustee has the right to withhold any estate tax imposed on the distribution.

Tax is imposed on (1) any distribution from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse. The tax is computed as an additional estate tax on the estate of the first spouse to die.

Transfers to charity.–Contributions to section 501(c)(3) charitable organizations and certain other organizations may be deducted from the value of a gift or from the value of the assets in an estate for Federal gift or estate tax purposes.[235] The effect of the deduction generally is to remove the full fair market value of assets transferred to charity from the gift or estate tax base; unlike the income tax charitable deduction, there are no percentage limits on the deductible amount. For estate tax purposes, the charitable deduction is limited to the value of the

[234] Secs. 2056 and 2523.

[235] Secs. 2055 and 2522.

transferred property that is required to be included in the gross estate.[236] A charitable contribution of a partial interest in property, such as a remainder or future interest, generally is not deductible for gift or estate tax purposes.[237]

The estate tax

Overview

The Code imposes a tax on the transfer of the taxable estate of a decedent who is a citizen or resident of the United States.[238] The taxable estate is determined by deducting from the value of the decedent's gross estate any deductions provided for in the Code. After applying tax rates to determine a tentative amount of estate tax, certain credits are subtracted to determine estate tax liability.[239]

Because the estate tax shares a common unified credit (exemption) and tax rate table with the gift tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

Gross estate

A decedent's gross estate includes, to the extent provided for in other sections of the Code, the date-of-death value of all of a decedent's property, real or personal, tangible or intangible, wherever situated.[240] In general, the value of property for this purpose is the fair market value of the property as of the date of the decedent's death, although an executor may

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[236] Sec. 2055(d).

[237] Secs. 2055(e)(2) and 2522(c)(2).

[238] Sec. 2001(a).

[239] More mechanically, the taxable estate is combined with the value of adjusted taxable gifts made during the decedent's life (generally, post-1976 gifts), before applying tax rates to determine a tentative total amount of tax. The portion of the tentative tax attributable to lifetime gifts is then subtracted from the total tentative tax to determine the gross estate tax, *i.e.*, the amount of estate tax before considering available credits. Credits are then subtracted to determine the estate tax liability.

This method of computation was designed to ensure that a taxpayer only gets one run up through the rate brackets for all lifetime gifts and transfers at death, at a time when the thresholds for applying the higher marginal rates exceeded the exemption amount. However, the higher ($5.49 million) present-law exemption amount effectively renders the lower rate brackets irrelevant, because the top marginal rate bracket applies to all transfers in excess of $1 million. In other words, all transfers that are not exempt by reason of the $5.49 million exemption amount are taxed at the highest marginal rate of 40 percent.

[240] Sec. 2031(a).

elect to value certain property as of the date that is six months after the decedent's death (the alternate valuation date).[241]

The gross estate includes not only property directly owned by the decedent, but also other property in which the decedent had a beneficial interest at the time of his or her death.[242] The gross estate also includes certain transfers made by the decedent prior to his or her death, including: (1) certain gifts made within three years prior to the decedent's death;[243] (2) certain transfers of property in which the decedent retained a life estate;[244] (3) certain transfers taking effect at death;[245] and (4) revocable transfers.[246] In addition, the gross estate also includes property with respect to which the decedent had, at the time of death, a general power of appointment (generally, the right to determine who will have beneficial ownership).[247] The value of a life insurance policy on the decedent's life is included in the gross estate if the proceeds are payable to the decedent's estate or the decedent had incidents of ownership with respect to the policy at the time of his or her death.[248]

Deductions from the gross estate

A decedent's taxable estate is determined by subtracting from the value of the gross estate any deductions provided for in the Code.

Marital and charitable transfers.−As described above, transfers to a surviving spouse or to charity generally are deductible for estate tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the estate tax base.

State death taxes.−An estate tax deduction is permitted for death taxes (*e.g.*, any estate, inheritance, legacy, or succession taxes) actually paid to any State or the District of Columbia, in respect of property included in the gross estate of the decedent.[249] Such State taxes must have been paid and claimed before the later of: (1) four years after the filing of the estate tax return; or (2) (a) 60 days after a decision of the U.S. Tax Court determining the estate tax liability

[241] Sec. 2032.

[242] Sec. 2033.

[243] Sec. 2035.

[244] Sec. 2036.

[245] Sec. 2037.

[246] Sec. 2038.

[247] Sec. 2041.

[248] Sec. 2042.

[249] Sec. 2058.

becomes final, (b) the expiration of the period of extension to pay estate taxes over time under section 6166, or (c) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has become final.

Other deductions.−A deduction is available for funeral expenses, estate administration expenses, and claims against the estate, including certain taxes.[250] A deduction also is available for uninsured casualty and theft losses incurred during the settlement of the estate.[251]

Credits against tax

After accounting for allowable deductions, a gross amount of estate tax is computed. Estate tax liability is then determined by subtracting allowable credits from the gross estate tax.

Unified credit.−The most significant credit allowed for estate tax purposes is the unified credit, which is discussed in greater detail above.[252] For 2017, the value of the unified credit is $2,141,800, which has the effect of exempting $5.49 million in transfers from tax. The unified credit available at death is reduced by the amount of unified credit used to offset gift tax on gifts made during the decedent's life.

Other credits.−Estate tax credits also are allowed for: (1) gift tax paid on certain pre-1977 gifts (before the estate and gift tax computations were integrated);[253] (2) estate tax paid on certain prior transfers (to limit the estate tax burden when estate tax is imposed on transfers of the same property in two estates by reason of deaths in rapid succession);[254] and (3) certain foreign death taxes paid (generally, where the property is situated in a foreign country but included in the decedent's U.S. gross estate).[255]

Provisions affecting small and family-owned businesses and farms

Special-use valuation.−An executor can elect to value for estate tax purposes certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current-use value, rather than its fair market value.[256] The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997; the inflation-adjusted amount for 2017 is $1,120,000). In general, real property generally qualifies for special-use

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[250] Sec. 2053.

[251] Sec. 2054.

[252] Sec. 2010.

[253] Sec. 2012.

[254] Sec. 2013.

[255] Sec. 2014. In certain cases, an election may be made to deduct foreign death taxes. See section 2053(d).

[256] Sec. 2032A.

valuation only if (1) at least 50 percent of the adjusted value of the decedent's gross estate (including both real and personal property) consists of a farm or closely-held business property in the decedent's estate and (2) at least 25 percent of the adjusted value of the gross estate consists of farm or closely held business real property. In addition, the property must be used in a qualified use (*e.g.*, farming) by the decedent or a member of the decedent's family for five of the eight years before the decedent's death.

If, after a special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death, an additional estate tax is imposed to recapture the entire estate-tax benefit of the special-use valuation.[257]

Installment payment of estate tax for closely held businesses.−Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely held business in two or more installments (but no more than 10).[258] An estate is eligible for payment of estate tax in installments if the value of the decedent's interest in a closely held business exceeds 35 percent of the decedent's adjusted gross estate (*i.e.*, the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax. A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998; the inflation-adjusted amount for 2017 is $1,490,000) in taxable value of a closely held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely held business in excess of $1 million (adjusted for inflation) is equal to 45 percent of the

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[257] Prior to 2004, an estate also was permitted to deduct the adjusted value of a qualified family-owned business interest of the decedent, up to $675,000. Sec. 2057. A qualified family-owned business interest generally was defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if the decedent's family owns at least 50 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent's family owns at least 30 percent of the trade or business. To qualify for the exclusion, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, at least one qualified heir (or member of the qualified heir's family) was required to have materially participated in the trade or business for at least 10 years following the decedent's death. The qualified family-owned business rules provided a graduated recapture based on the number of years after the decedent's death within which a disqualifying event occurred.

The qualified family-owned business deduction and the unified credit effective exemption amount were coordinated. If the maximum deduction amount of $675,000 is elected, then the unified credit effective exemption amount is $625,000, for a total of $1.3 million. If the qualified family-owned business deduction is less than $675,000, then the unified credit effective exemption amount is equal to $625,000, increased by the difference between $675,000 and the amount of the qualified family-owned business deduction. However, the unified credit effective exemption amount cannot be increased above such amount in effect for the taxable year. Because of the coordination between the qualified family-owned business deduction and the unified credit effective exemption amount, the qualified family-owned business deduction did not provide a benefit in any year in which the applicable exclusion amount exceeded $1.3 million.

[258] Sec. 6166.

rate applicable to underpayments of tax under section 6621 of the Code (*i.e.*, 45 percent of the Federal short-term rate plus three percentage points).[259] Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

The Gift Tax

Overview

The Code imposes a tax for each calendar year on the transfer of property by gift during such year by any individual, whether a resident or nonresident of the United States.[260] The amount of taxable gifts for a calendar year is determined by subtracting from the total amount of gifts made during the year: (1) the gift tax annual exclusion (described below); and (2) allowable deductions.

Gift tax for the current taxable year is determined by: (1) computing a tentative tax on the combined amount of all taxable gifts for the current and all prior calendar years using the common gift tax and estate tax rate table; (2) computing a tentative tax only on all prior-year gifts; (3) subtracting the tentative tax on prior-year gifts from the tentative tax computed for all years to arrive at the portion of the total tentative tax attributable to current-year gifts; and, finally, (4) subtracting the amount of unified credit not consumed by prior-year gifts.

Because the gift tax shares a common unified credit (exemption) and tax rate table with the estate tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

Transfers by gift

The gift tax applies to a transfer by gift regardless of whether: (1) the transfer is made outright or in trust; (2) the gift is direct or indirect; or (3) the property is real or personal, tangible or intangible.[261] For gift tax purposes, the value of a gift of property is the fair market value of the property at the time of the gift.[262] Where property is transferred for less than full consideration, the amount by which the value of the property exceeds the value of the consideration is considered a gift and is included in computing the total amount of a taxpayer's gifts for a calendar year.[263]

For a gift to occur, a donor generally must relinquish dominion and control over donated property. For example, if a taxpayer transfers assets to a trust established for the benefit of his or

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[259] The interest rate on this portion adjusts with the Federal short-term rate.

[260] Sec. 2501(a).

[261] Sec. 2511(a).

[262] Sec. 2512(a).

[263] Sec. 2512(b).

her children, but retains the right to revoke the trust, the taxpayer may not have made a completed gift, because the taxpayer has retained dominion and control over the transferred assets. A completed gift made in trust, on the other hand, often is treated as a gift to the trust beneficiaries.

By reason of statute, certain transfers are not treated as transfers by gift for gift tax purposes. These include, for example, certain transfers for educational and medical purposes,[264] transfers to section 527 political organizations,[265] and transfers to tax-exempt organizations described in sections 501(c)(4), (5), or (6).[266]

Taxable gifts

As stated above, the amount of a taxpayer's taxable gifts for the year is determined by subtracting from the total amount of the taxpayer's gifts for the year the gift tax annual exclusion and any available deductions.

Gift tax annual exclusion.–Under present law, donors of lifetime gifts are provided an annual exclusion of $14,000 per donee in 2017 (indexed for inflation from the 1997 annual exclusion amount of $10,000) for gifts of present interests in property during the taxable year.[267] If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $28,000 per donee in 2017. In general, unlimited transfers between spouses are permitted without imposition of a gift tax. Special rules apply to the contributions to a qualified tuition program ("529 Plan") including an election to treat a contribution that exceeds the annual exclusion as a contribution made ratably over a five-year period beginning with the year of the contribution.[268]

Marital and charitable deductions.–As described above, transfers to a surviving spouse or to charity generally are deductible for gift tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the gift tax base.

The generation-skipping transfer tax

A generation-skipping transfer tax generally is imposed (in addition to the gift tax or the estate tax) on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation below that of the transferor). Transfers

[264] Sec. 2503(e).

[265] Sec. 2501(a)(4).

[266] Sec. 2501(a)(6).

[267] Sec. 2503(b).

[268] Sec. 529(c)(2).

subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Exemption and tax rate

An exemption generally equal to the estate tax exemption amount ($5.49 million for 2017) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property, and in some cases is automatically allocated. The allocation of generation-skipping transfer tax exemption effectively reduces the tax rate on a generation-skipping transfer.

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate (40 percent) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred indicates the amount of "generation-skipping transfer tax exemption" allocated to a trust (or to property transferred in a direct skip) relative to the total value of property transferred.[269] If, for example, a taxpayer transfers $5 million in property to a trust and allocates $5 million of exemption to the transfer, the inclusion ratio is zero, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is zero percent (40 percent multiplied by the inclusion ratio of zero). If, however, the taxpayer allocated only $2.5 million of exemption to the transfer, the inclusion ratio is 0.5, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is 20 percent (40 percent multiplied by the inclusion ratio of 0.5). If the taxpayer allocates no exemption to the transfer, the inclusion ratio is one, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is 40 percent (40 percent multiplied by the inclusion ratio of one).

Generation-skipping transfers

Generation-skipping transfer tax generally is imposed at the time of a generation-skipping transfer − a direct skip, a taxable termination, or a taxable distribution.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (*e.g.*, grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person.

[269] The inclusion ratio is one minus the applicable fraction. The applicable fraction is the amount of exemption allocated to a trust (or to a direct skip) divided by the value of assets transferred.

A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates generation-skipping transfer tax exemption to a trust prior to the taxable distribution, generation-skipping transfer tax may be avoided.

Income tax basis in property received

In general

Gain or loss, if any, on the disposition of property is measured by the taxpayer's amount realized (*i.e.*, gross proceeds received) on the disposition, less the taxpayer's basis in such property. Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

A gift or bequest of appreciated (or loss) property is not an income tax realization event for the transferor. The Code provides special rules for determining a recipient's basis in assets received by lifetime gift or from a decedent.

Basis in property received by lifetime gift

Under present law, property received from a donor of a lifetime gift generally takes a carryover basis. "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift. If a donor's basis in property is greater than the fair market value of the property on the date of the gift, then, for purposes of determining loss on a subsequent sale of the property, the donee's basis is the property's fair market value on the date of the gift.

Basis in property acquired from a decedent

Property acquired from a decedent's estate generally takes a stepped-up basis. "Stepped-up basis" means that the basis of property acquired from a decedent's estate generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). Providing a fair market value basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent's death and eliminates the tax benefit from any unrealized loss.

In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent and, thus, is eligible for stepped-up basis. Thus, both the decedent's one-half share and the surviving spouse's one-half share are stepped up to fair market value. This rule applies if at least one-half of the whole of the community interest is includible in the decedent's gross estate.

Stepped-up basis treatment generally is denied to certain interests in foreign entities. Stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that stock of a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped-up basis. Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped-up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (*i.e.*, generally the date of the decedent's death unless an alternate valuation date is elected).

Description of Proposal

The proposal doubles the estate and gift tax exemption amount for decedents dying and gifts made after December 31, 2017. This is accomplished by increasing the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011.

For estates of decedents dying and generation-skipping transfers made after December 31, 2023, the proposal repeals the estate tax and the generation-skipping transfer tax. The proposal includes a transition rule for assets placed in a qualified domestic trust by a decedent who died before the effective date of the proposal. Specifically, estate tax will not be imposed on: (1) distributions before the death of a surviving spouse from the trust more than 10 years after the date of enactment; or (2) assets remaining in the qualified domestic trust upon the death of the surviving spouse. The top marginal gift tax rate is reduced to 35 percent for gifts made after December 31, 2023.

The proposal generally retains the present law rules for determining the income tax basis of assets acquired by gift and assets acquired from a decedent. As a result, property received from a donor of a lifetime gift generally will continue to take a carryover basis, and property acquired from a decedent's estate generally will continue to take a stepped-up basis.

Effective Date

The proposal to double the estate and gift tax exemption is effective for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017. The repeal of the estate and generation-skipping transfer taxes, and the reduction in the gift tax rate to 35 percent, are effective for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2023.

TITLE II – ALTERNATIVE MINIMUM TAX REPEAL

1. Repeal of alternative minimum tax

<u>**Present Law**</u>

<u>**Individual alternative minimum tax**</u>

<u>In general</u>

An alternative minimum tax ("AMT") is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. For taxable years beginning in 2017, the tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $187,800 ($93,900 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The breakpoints are indexed for inflation. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the taxable income adjusted to take account of specified tax preferences and adjustments.

The exemption amounts for taxable years beginning in 2017 are: (1) $84,500 in the case of married individuals filing a joint return and surviving spouses; (2) $54,300 in the case of other unmarried individuals; (3) $42,250 in the case of married individuals filing separate returns; and (4) $24,100 in the case of an estate or trust. For taxable years beginning in 2017, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $160,900 in the case of married individuals filing a joint return and surviving spouses, (2) $120,700 in the case of other unmarried individuals, and (3) $80,450 in the case of married individuals filing separate returns or an estate or a trust. The amounts are indexed for inflation.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

<u>Preference items in computing AMTI</u>

The minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of each mineral property (other than oil and gas properties) at the end of the taxable year.

2. The amount by which excess intangible drilling costs (*i.e.*, expenses in excess the amount that would have been allowable if amortized over a 10-year period) exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference applies to independent producers only to the extent it reduces the producer's AMTI (determined without regard to this preference and the net operating loss deduction) by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

5. Seven percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm activity or passive activities are not taken into account in computing AMTI.

Adjustments in computing AMTI

The adjustments that individuals must make to compute AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs are capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

4. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

5. Mining exploration and development costs are capitalized and amortized over a 10-year period.

6. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

7. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), is calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

8. Miscellaneous itemized deductions are not allowed.

9. Itemized deductions for State, local, and foreign real property taxes; State and local personal property taxes; State, local, and foreign income, war profits, and excess profits taxes; and State and local sales taxes are not allowed.

10. Medical expenses are allowed only to the extent they exceed ten percent of the taxpayer's adjusted gross income.

11. Deductions for interest on home equity loans are not allowed.

12. The standard deduction and the deduction for personal exemptions are not allowed.

13. The amount allowable as a deduction for circulation expenditures is capitalized and amortized over a three-year period.

14. The amount allowable as a deduction for research and experimentation expenditures from passive activities is capitalized and amortized over a 10-year period.

15. The regular tax rules relating to incentive stock options do not apply.

Other rules

The taxpayer's net operating loss deduction generally cannot reduce the taxpayer's AMTI by more than 90 percent of the AMTI (determined without the net operating loss deduction).

The alternative minimum tax foreign tax credit reduces the tentative minimum tax.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax liability in such subsequent year. The AMT credit is allowed only to the extent that the taxpayer's AMT liability is the result of adjustments that are timing in nature. The

individual AMT adjustments relating to itemized deductions and personal exemptions are not timing in nature, and no minimum tax credit is allowed with respect to these items.

An individual may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Corporate alternative minimum tax

In general

An AMT is also imposed on a corporation to the extent the corporation's tentative minimum tax exceeds its regular tax. This tentative minimum tax is computed at the rate of 20 percent on the AMTI in excess of a $40,000 exemption amount that phases out. The exemption amount is phased out by an amount equal to 25 percent of the amount that the corporation's AMTI exceeds $150,000.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation with average gross receipts of less than $7.5 million for the prior three taxable years is exempt from the corporate minimum tax. The $7.5 million threshold is reduced to $5 million for the corporation's first three-taxable year period.

Preference items in computing AMTI

The corporate minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

2. The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

Adjustments in computing AMTI

The adjustments that corporations must make in computing AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property which is allowed "bonus depreciation" for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs must be capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

4. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

5. The special rules applicable to Merchant Marine construction funds are not applicable.

6. The special deduction allowable under section 833(b) for Blue Cross and Blue Shield organizations is not allowed.

7. The adjusted current earnings adjustment applies, as described below.

Adjusted current earning ("ACE") adjustment

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings of a corporation exceed its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction). In determining ACE the following rules apply:

1. For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.

2. Amounts excluded from gross income under the regular tax but included for purposes of determining earnings and profits are generally included in determining ACE.

3. The inside build-up of a life insurance contract is included in ACE (and the related premiums are deductible).

4. Intangible drilling costs of integrated oil companies must be capitalized and amortized over a 60-month period.

5. The regular tax rules of section 173 (allowing circulation expenses to be amortized) and section 248 (allowing organizational expenses to be amortized) do not apply.

6. Inventory must be calculated using the FIFO, rather than LIFO, method.

7. The installment sales method generally may not be used.

8. No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

9. Depletion (other than for oil and gas properties) must be calculated using the cost, rather than the percentage, method.

10. In certain cases, the assets of a corporation that has undergone an ownership change must be stepped down to their fair market values.

Other rules

The taxpayer's net operating loss carryover generally cannot reduce the taxpayer's AMT liability by more than 90 percent of AMTI determined without this deduction.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If a corporation is subject to AMT in any year, the amount of AMT is allowed as an AMT credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in the subsequent year. Corporations are allowed to claim a limited amount of AMT credits in lieu of bonus depreciation.

A corporation may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Description of Proposal

The proposal repeals the individual and corporate alternative minimum tax.

The proposal allows the AMT credit to offset the taxpayer's regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2018 and before 2023 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2022) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit will be allowed in taxable years beginning before 2023.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

In determining the alternative minimum taxable income for taxable years beginning before January 1, 2018, the net operating loss deduction carryback from taxable years beginning after December 31, 2017, are determined without regard to any AMT adjustments or preferences.

The repeal of the election to write off certain expenditures over a specified period applies to amounts paid or incurred after December 31, 2017.

TITLE III – BUSINESS TAX REFORM

A. Tax Rates

1. Reduction in corporate tax rate

Present Law

Corporate taxable income is subject to tax under a four-step graduated rate structure.[270] The top corporate tax rate is 35 percent on taxable income in excess of $10 million. The corporate taxable income brackets and tax rates are as set forth in the table below.

Taxable Income	Tax rate (percent)
Not over $50,000	15
Over $50,000 but not over $75,000	25
Over $75,000 but not over $10,000,000	34
Over $10,000,000	35

An additional five-percent tax is imposed on a corporation's taxable income in excess of $100,000. The maximum additional tax is $11,750. Also, a second additional three-percent tax is imposed on a corporation's taxable income in excess of $15 million. The maximum second additional tax is $100,000.

Certain personal service corporations pay tax on their entire taxable income at the rate of 35 percent.[271]

Present law provides if the maximum corporate tax rate exceeds 35 percent, the maximum rate on a corporation's net capital gain will be 35 percent.[272]

Description of Proposal

The proposal eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 20 percent.

Personal service corporations are taxed at 25 percent.

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[270] Sec. 11(a) and (b)(1).

[271] Sec. 11(b)(2).

[272] Sec. 1201(a).

The proposal repeals the maximum corporate tax rate on net capital gain as obsolete.

For taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the proposal provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the date of enactment).

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

B. Cost Recovery

1. Increased expensing

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[273] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[274] and convention.[275]

Bonus depreciation

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2020 (January 1, 2021, for longer production period property[276] and certain aircraft[277]).[278] The 50-percent allowance is phased down for property placed in service after December 31, 2017 (after December 31, 2018 for longer production period property and certain aircraft). The bonus depreciation percentage rates are as follows.

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[273] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

[274] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[275] Sec. 168.

[276] As defined in section 168(k)(2)(B).

[277] As defined in section 168(k)(2)(C).

[278] Sec. 168(k). The additional first-year depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A.

Placed in Service Year	Bonus Depreciation Percentage	
	Qualified Property in General	**Longer Production Period Property and Certain Aircraft**
2017	50 percent	50 percent
2018	40 percent	50 percent[279]
2019	30 percent	40 percent
2020	n/a	30 percent[280]

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax ("AMT"),[281] but is not allowed in computing earnings and profits.[282] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.[283] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.[284] The taxpayer may elect out of the additional first-year depreciation for any class of property for any taxable year.[285]

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2017 a taxpayer purchases new depreciable property and places it in service.[286] The property's cost is $10,000, and it is five-year property subject to the 200 percent declining balance method and half-year convention. The amount of additional first-year depreciation allowed is $5,000. The remaining $5,000 of the cost of the property is depreciable under the rules applicable to five-year property.

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[279] It is intended that for longer production period property placed in service in 2018, 50 percent applies to the entire adjusted basis. Similarly, for longer production period property placed in service in 2019, 40 percent applies to the entire adjusted basis. A technical correction may be necessary with respect to longer production period property placed in service in 2018 and 2019 so that the statute reflects this intent.

[280] In the case of longer production period property described in section 168(k)(2)(B) and placed in service in 2020, 30 percent applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2020, and the remaining adjusted basis does not qualify for bonus depreciation. Thirty percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2020.

[281] Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)-1(d).

[282] Sec. 312(k)(3) and Treas. Reg. sec. 1.168(k)-1(f)(7).

[283] Sec. 168(k)(1)(B).

[284] *Ibid.*

[285] Sec. 168(k)(7). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)-1(e)(2).

[286] Assume that the cost of the property is not eligible for expensing under section 179 or Treas. Reg. sec. 1.263(a)-1(f).

Thus, $1,000 also is allowed as a depreciation deduction in 2017.[287] The total depreciation deduction with respect to the property for 2017 is $6,000. The remaining $4,000 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Qualified property

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements.[288] First, the property must be: (1) property to which MACRS applies with an applicable recovery period of 20 years or less; (2) water utility property;[289] (3) computer software other than computer software covered by section 197; or (4) qualified improvement property.[290] Second, the original use[291] of the property must commence with the taxpayer.[292] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2020. As noted above, an extension of the placed-in-service date of one year (*i.e.*, before January 1, 2021) is provided for certain property with a recovery period of 10 years or longer, certain transportation property, and certain aircraft.[293]

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[287] $1,000 results from the application of the half-year convention and the 200 percent declining balance method to the remaining $5,000.

[288] Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

[289] As defined in section 168(e)(5).

[290] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i).

[291] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)-1(b)(3).

[292] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii) and (iii).

[293] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

To qualify, property must be acquired (1) before January 1, 2020, or (2) pursuant to a binding written contract which was entered into before January 1, 2020. With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2020.[294] Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.[295] For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2020 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[296]

Qualified improvement property

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.[297] Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Election to accelerate AMT credits in lieu of bonus depreciation

A corporation otherwise eligible for additional first-year depreciation may elect to claim additional AMT credits in lieu of claiming additional depreciation with respect to qualified property.[298] In the case of a corporation making this election, the straight line method is used for the regular tax and the AMT with respect to qualified property.[299]

A corporation making an election increases the tax liability limitation under section 53(c) on the use of minimum tax credits by the bonus depreciation amount. The aggregate increase in credits allowable by reason of the increased limitation is treated as refundable.

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[294] Sec. 168(k)(2)(E)(i).

[295] Treas. Reg. sec. 1.168(k)-1(b)(4)(iii).

[296] Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

[297] Sec. 168(k)(3).

[298] Sec. 168(k)(4).

[299] Sec. 168(k)(4)(A)(ii).

The bonus depreciation amount generally is equal to 20 percent of bonus depreciation for qualified property that could be claimed as a deduction absent an election under this provision.[300] As originally enacted, the bonus depreciation amount for all taxable years was limited to the lesser of (1) $30 million or (2) six percent of the minimum tax credits allocable to the adjusted net minimum tax imposed for taxable years beginning before January 1, 2006. However, extensions of this provision have provided that this limitation applies separately to property subject to each extension.

For taxable years ending after December 31, 2015, the bonus depreciation amount for a taxable year (as defined under present law with respect to all qualified property) is limited to the lesser of (1) 50 percent of the minimum tax credit for the first taxable year ending after December 31, 2015 (determined before the application of any tax liability limitation) or (2) the minimum tax credit for the taxable year allocable to the adjusted net minimum tax imposed for taxable years ending before January 1, 2016 (determined before the application of any tax liability limitation and determined on a first-in, first-out basis).

All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.[301]

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, bonus depreciation does not apply to any qualified property and the straight line method is used with respect to that property.[302]

In the case of a partnership having a single corporate partner owning (directly or indirectly) more than 50 percent of the capital and profits interests in the partnership, each partner takes into account its distributive share of partnership depreciation in determining its bonus depreciation amount.[303]

Special rules

Passenger automobiles

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year

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300 For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation determined if section 168(k)(1) applied to all qualified property placed in service during the taxable year and (ii) the amount of depreciation that would be so determined if section 168(k)(1) did not so apply. This determination is made using the most accelerated depreciation method and the shortest life otherwise allowable for each property.

301 Sec. 168(k)(4)(B)(iii).

302 Sec. 168(k)(4)(D)(ii).

303 Sec. 168(k)(4)(D)(iii).

deduction).[304] The $8,000 amount is phased down from $8,000 by $1,600 per calendar year beginning in 2018. Thus, the section 280F increase amount for property placed in service during 2018 is $6,400, and during 2019 is $4,800. While the underlying section 280F limitation is indexed for inflation,[305] the section 280F increase amount is not indexed for inflation. The increase does not apply to a taxpayer who elects to accelerate AMT credits in lieu of bonus depreciation for a taxable year.

Certain plants bearing fruits and nuts

A special election is provided for certain plants bearing fruits and nuts.[306] Under the election, the applicable percentage of the adjusted basis of a specified plant which is planted or grafted after December 31, 2015, and before January 1, 2020, is deductible for regular tax and AMT purposes in the year planted or grafted by the taxpayer, and the adjusted basis is reduced by the amount of the deduction.[307] The percentage is 50 percent for 2017, 40 percent for 2018, and 30 percent for 2019. A specified plant is any tree or vine that bears fruits or nuts, and any other plant that will have more than one yield of fruits or nuts and generally has a preproductive period of more than two years from planting or grafting to the time it begins bearing fruits or nuts.[308] The election is revocable only with the consent of the Secretary, and if the election is made with respect to any specified plant, such plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.

Long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[309] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service before January 1, 2020 (January 1, 2021, in the case of longer production period property).[310]

[304] Sec. 168(k)(2)(F).

[305] Sec. 280F(d)(7).

[306] See sec. 168(k)(5).

[307] Any amount deducted under this election is not subject to capitalization under section 263A.

[308] A specified plant does not include any property that is planted or grafted outside the United States.

[309] Sec. 460.

[310] Sec. 460(c)(6). Other dates involving prior years are not described herein.

Description of Proposal

Extension of bonus depreciation and temporary 100 percent expensing for certain business assets

The proposal extends and modifies the additional first-year depreciation deduction through 2022 (through 2023 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023.

Special rules

The $8,000 increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles is increased from $8,000 to $16,000 for passenger automobiles acquired and placed in service after September 27, 2017, and before January 1, 2023.

The proposal extends the special rule under the percentage-of-completion method for the allocation of bonus depreciation to a long-term contract for property placed in service before January 1, 2023 (January 1, 2024, in the case of longer production period property).

Application to used property

The proposal removes the requirement that the original use of qualified property must commence with the taxpayer. Thus, the proposal applies to purchases of used as well as new items. To prevent abuses, the additional first-year depreciation deduction applies only to property purchased in an arm's-length transaction. It does not apply to property received as a gift or from a decedent.[311] In the case of trade-ins, like-kind exchanges, or involuntary conversions, it applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property.[312] It does not apply to property acquired in a nontaxable exchange such as a reorganization, nor to property bought from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in section 267, nor from a person who controls, is controlled by, or is under common control with the taxpayer.[313] Thus it does not apply, for example, if one member of an affiliated group of corporations purchases property from another member, or if an individual who controls a corporation purchases property from that corporation.

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[311] By reference to section 179(d)(2)(C). See also Treas. Reg. sec. 1.179-4(c)(1)(iv).

[312] By reference to section 179(d)(3). See also Treas. Reg. sec. 1.179-4(d).

[313] By reference to section 179(d)(2)(A) and (B). See also Treas. Reg. sec. 1.179-4(c).

Exception for certain businesses not subject to limitation on interest expense

The proposal excludes from the definition of qualified property any property used in a real property trade or business, *i.e.*, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.[314]

The proposal also excludes from the definition of qualified property any property used in the trade or business of certain regulated public utilities, *i.e.*, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.[315]

Election to accelerate AMT credits in lieu of bonus depreciation

As a conforming amendment to the repeal of AMT,[316] the proposal repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Transition rule

The phase-down of bonus depreciation is maintained for property acquired before September 28, 2017, and placed in service after September 27, 2017. Under the proposal, in the case of property acquired and adjusted basis incurred before September 28, 2017, the bonus depreciation rates are as follows.

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[314] As defined in section 3301 of the bill (Interest), by cross reference to section 469(c)(7)(C). Note that a mortgage broker who is a broker of financial instruments is not in a real property trade or business for this purpose. See, *e.g.*, CCA 201504010 (December 17, 2014).

[315] As defined in section 3301 of the bill (Interest).

[316] See section 2001 of the bill (Repeal of alternative minimum tax).

Phase-Down for Portion of Basis of Qualified Property Acquired before September 28, 2017		
Placed in Service Year	**Bonus Depreciation Percentage**	
	Qualified Property in General	**Longer Production Period Property and Certain Aircraft**
2017	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	n/a	30 percent

Similarly, the section 280F increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles acquired before September 28, 2017, and placed in service after September 27, 2017, is $8,000 for 2017, $6,400 for 2018, and $4,800 for 2019.

Effective Date

The proposal generally applies to property acquired[317] and placed in service after September 27, 2017, and to specified plants planted or grafted after such date.

A transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply section 168 without regard to the amendments made by this proposal.

In the case of any taxable year that includes any portion of the period beginning on September 28, 2017, and ending on December 31, 2017, the amount of any net operating loss for such taxable year which may be treated as a net operating loss carryback is determined without regard to the amendments made by this proposal.[318]

[317] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[318] See section 3302 of the bill (Modification of net operating loss deduction).

C. Small Business Reforms

1. Expansion of section 179 expensing

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[319] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[320] and convention.[321]

Election to expense certain depreciable business assets

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation. The maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year.[322] The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.[323] The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2015.[324]

In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.[325] Qualifying property also

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[319] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

[320] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[321] Sec. 168.

[322] Sec. 179(b)(1).

[323] Sec. 179(b)(2).

[324] Sec. 179(b)(6).

[325] Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F. For sport utility vehicles above the 6,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000. Sec. 179(b)(5).

includes off-the-shelf computer software and qualified real property (*i.e.*, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[326] Qualifying property excludes any property described in section 50(b) (*i.e.*, certain property not eligible for the investment tax credit).[327]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision).[328] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations).

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[329] If a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.[330]

An expensing election is made under rules prescribed by the Secretary.[331] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner.

Description of Proposal

The proposal increases the maximum amount a taxpayer may expense under section 179 to $5,000,000, and increases the phase-out threshold amount to $20,000,000 for five taxable years, *i.e.*, for taxable years beginning in 2018, 2019, 2020, 2021 and 2022. Thus, the proposal provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017 and before 2023, is $5,000,000 of the cost of qualifying property placed in service for the taxable year. The $5,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $20,000,000. The $5,000,000 and $20,000,000 amounts are indexed for inflation for taxable years beginning after 2018.

The proposal also expands the definition of qualified real property qualifying for section 179 to include qualified energy efficient heating and air-conditioning property acquired

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[326] Sec. 179(d)(1)(A)(ii) and (f).

[327] Sec. 179(d)(1) flush language.

[328] Sec. 179(b)(3).

[329] Sec. 179(d)(9).

[330] Sec. 312(k)(3)(B).

[331] Sec. 179(c)(1).

and placed in service by the taxpayer after November 2, 2017. For purposes of the proposal, qualified energy efficient heating and air-conditioning property means any depreciable section 1250 property that is (i) installed as part of a building's heating, cooling, ventilation, or hot water system, and (ii) within the scope of Standard 90.1-2007 of the American Society of Heating, Refrigerating, and Air-Conditioning Engineers and the Illuminating Engineering Society of North America (as in effect on the day before the date of the adoption of Standard 90.1-2010 of such Societies) or any successor standard.

Effective Date

The increased dollar limitations under section 179 apply to taxable years beginning after December 31, 2017.

The expansion of qualified real property to include qualified energy efficient heating and air-conditioning property applies to property acquired[332] and placed in service after November 2, 2017.

2. Small business accounting method reform and simplification

Present Law

General rule for methods of accounting

Section 446 generally allows a taxpayer to select the method of accounting to be used to compute taxable income, provided that such method clearly reflects the income of the taxpayer. The term "method of accounting" includes not only the overall method of accounting used by the taxpayer, but also the accounting treatment of any one item.[333] Permissible overall methods of accounting include the cash receipts and disbursements method ("cash method"), an accrual method, or any other method (including a hybrid method) permitted under regulations prescribed by the Secretary.[334] Examples of any one item for which an accounting method may be adopted include cost recovery,[335] revenue recognition,[336] and timing of deductions.[337] For each separate

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[332] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[333] Treas. Reg. sec. 1.446-1(a)(1).

[334] Sec. 446(c).

[335] See, *e.g.*, secs. 167 and 168.

[336] See, *e.g.*, secs. 451 and 460.

[337] See, *e.g.*, secs. 461 and 467.

trade or business, a taxpayer is entitled to adopt any permissible method, subject to certain restrictions.[338]

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[339] Except as otherwise provided, section 446(e) requires taxpayers to secure consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how an adoption of a method of accounting occurs, and (3) how a change in method of accounting is effectuated.[340]

Cash and accrual methods

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

Taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.[341] Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.[342] Accrual methods of accounting generally result in a more accurate measure of economic income than does the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method. Exceptions are made for farming businesses, qualified personal service corporations, and the aforementioned entities to the extent their average annual gross receipts do not exceed $5 million for all prior years (including the prior taxable years of any predecessor of the entity) (the "gross receipts test"). The cash method may not be used by any tax shelter.[343] In addition, the cash

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338 Sec. 446(d); Treas. Reg. sec. 1.446-1(d).

339 Treas. Reg. sec. 1.446-1(e)(1).

340 Treas. Reg. sec. 1.446-1(e).

341 See, *e.g.*, sec. 451.

342 See, *e.g.*, sec. 461.

343 Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale; (2) any syndicate (within the meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not

method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.[344] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[345]

A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees.[346] Such farming businesses are not precluded from using the cash method regardless of whether they meet the gross receipts test. However, section 447 generally requires a farming C corporation (and any farming partnership if a corporation is a partner in such partnership) to use an accrual method of accounting. Section 447 does not apply to nursery or sod farms, to the raising or harvesting of trees (other than fruit and nut trees), nor to farming C corporations meeting a gross receipts test with a $1 million threshold. For family farm C corporations, the threshold under the gross receipts test is $25 million.

A qualified personal service corporation is a corporation: (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or heirs. Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the gross receipts test.

Accounting for inventories

In general, for Federal income tax purposes, taxpayers must account for inventories if the production, purchase, or sale of merchandise is an income-producing factor to the taxpayer.[347] Treasury regulations also provide that in any case in which the use of inventories is necessary to clearly reflect income, the accrual method must be used with regard to purchases and sales.[348] However, an exception is provided for taxpayers whose average annual gross receipts do not exceed $1 million.[349] A second exception is provided for taxpayers in certain industries whose average annual gross receipts do not exceed $10 million and that are not otherwise prohibited

an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

344 Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

345 Sec. 471 and Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

346 Sec. 448(d)(1).

347 Sec. 471(a) and Treas. Reg. sec. 1.471-1.

348 Treas. Reg. sec. 1.446-1(c)(2).

349 Rev. Proc. 2001-10, 2001-1 C.B. 272.

from using the cash method under section 448.[350] Such taxpayers may account for inventory as materials and supplies that are not incidental (*i.e.*, "non-incidental materials and supplies").[351]

In those circumstances in which a taxpayer is required to account for inventory, the taxpayer must maintain inventory records to determine the cost of goods sold during the taxable period. Cost of goods sold generally is determined by adding the taxpayer's inventory at the beginning of the period to the purchases made during the period and subtracting from that sum the taxpayer's inventory at the end of the period.

Because of the difficulty of accounting for inventory on an item-by-item basis, taxpayers often use conventions that assume certain item or cost flows. Among these conventions are the first-in, first-out ("FIFO") method, which assumes that the items in ending inventory are those most recently acquired by the taxpayer, and the last-in, first-out ("LIFO") method, which assumes that the items in ending inventory are those earliest acquired by the taxpayer.

Uniform capitalization

The uniform capitalization rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.[352] For real or personal property acquired by the taxpayer for resale, section 263A generally requires certain direct and indirect costs allocable to such property to be included in inventory.

Section 263A provides a number of exceptions to the general uniform capitalization requirements. One such exception exists for certain small taxpayers who acquire property for resale and have $10 million or less of average annual gross receipts;[353] such taxpayers are not required to include additional section 263A costs in inventory. Another exception exists for taxpayers who raise, harvest, or grow trees.[354] Under this exception, section 263A does not apply to trees raised, harvested, or grown by the taxpayer (other than trees bearing fruit, nuts, or other crops, or ornamental trees) and any real property underlying such trees. Similarly, the uniform capitalization rules do not apply to any plant having a preproductive period of two years or less or to any animal, which is produced by a taxpayer in a farming business (unless the

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[350] Rev. Proc. 2002-28, 2002-1 C.B. 815.

[351] Treas. Reg. sec. 1.162-3(a)(1). A deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations.

[352] Sec. 263A.

[353] Sec. 263A(b)(2)(B). No exception is available for small taxpayers who produce property subject to section 263A. However, a *de minimis* rule under Treasury regulations treats producers with total indirect costs of $200,000 or less as having no additional indirect costs beyond those normally capitalized for financial accounting purposes. Treas. Reg. sec. 1.263A-2(b)(3)(iv).

[354] Sec. 263A(c)(5).

taxpayer is required to use an accrual method of accounting under section 447 or 448(a)(3)).[355] Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[356]

Accounting for long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[357] Under this method, the taxpayer must include in gross income for the taxable year an amount equal to the product of (1) the gross contract price and (2) the percentage of the contract completed during the taxable year.[358] The percentage of the contract completed during the taxable year is determined by comparing costs allocated to the contract and incurred before the end of the taxable year with the estimated total contract costs.[359] Costs allocated to the contract typically include all costs (including depreciation) that directly benefit or are incurred by reason of the taxpayer's long-term contract activities.[360] The allocation of costs to a contract is made in accordance with regulations.[361] Costs incurred with respect to the long-term contract are deductible in the year incurred, subject to general accrual method of accounting principles and limitations.[362]

An exception from the requirement to use the percentage-of-completion method is provided for certain construction contracts ("small construction contracts"). Contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer whose average annual gross receipts for the prior three taxable years do not exceed $10 million.[363] Thus, long-term contract income from small construction contracts must be reported consistently using the

[355] Sec. 263A(d).

[356] Sec. 263A(h). Qualified creative expenses are defined as amounts paid or incurred by an individual in the trade or business of being a writer, photographer, or artist. However, such term does not include any expense related to printing, photographic plates, motion picture files, video tapes, or similar items.

[357] Sec. 460(a).

[358] See Treas. Reg. sec. 1.460-4. This calculation is done on a cumulative basis. Thus, the amount included in gross income in a particular year is that proportion of the expected contract price that the amount of costs incurred through the end of the taxable year bears to the total expected costs, reduced by the amounts of gross contract price included in gross income in previous taxable years.

[359] Sec. 460(b)(1).

[360] Sec. 460(c).

[361] Treas. Reg. sec. 1.460-5.

[362] Treas. Reg. secs. 1.460-4(b)(2)(iv) and 1.460-1(b)(8).

[363] Secs. 460(e)(1)(B) and (4).

taxpayer's exempt contract method.[364] Permissible exempt contract methods include the completed contract method, the exempt-contract percentage-of-completion method, the percentage-of-completion method, or any other permissible method.[365]

Description of Proposal

The proposal expands the universe of taxpayers that may use the cash method of accounting. Under the proposal, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period (the "$25 million gross receipts test") to use the cash method. The $25 million amount is indexed for inflation for taxable years beginning after 2018.

The proposal expands the universe of farming C corporations (and farming partnerships with a C corporation partner) that may use the cash method to include any farming C corporation (or farming partnership with a C corporation partner) that meets the $25 million gross receipts test.

The proposal retains the exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations. Thus, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other passthrough entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of such method clearly reflects income.[366]

In addition, the proposal also exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under section 471[367], but rather may use a method of accounting for

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[364] Since such contracts involve the construction of real property, they are subject to the interest capitalization rules without regard to their duration. See Treas. Reg. sec. 1.263A-8.

[365] Treas. Reg. sec. 1.460-4(c)(1).

[366] Consistent with present law, the cash method generally may not be used by taxpayers, other than those that meet the $25 million gross receipts test, if the purchase, production, or sale of merchandise is an income-producing factor. In addition, the cash method may not be used by a tax shelter.

[367] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

inventories that either (1) treats inventories as non-incidental materials and supplies[368], or (2) conforms to the taxpayer's financial accounting treatment of inventories.[369]

The proposal expands the exception for small taxpayers from the uniform capitalization rules. Under the proposal, any producer or reseller that meets the $25 million gross receipts test is exempted from the application of section 263A.[370] The proposal retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts.

Finally, the proposal expands the exception for small construction contracts from the requirement to use the percentage-of-completion method. Under the proposal, contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the taxable year in which the contract was entered into) meets the $25 million gross receipts test.[371]

Under the proposal, a taxpayer who fails the $25 million gross receipts test would not be eligible for any of the aforementioned exceptions (*i.e.*, from the accrual method, from keeping inventories, from applying the uniform capitalization rules, or from using the percentage-of completion method) for such taxable year.

Effective Date

The proposals to expand the universe of taxpayers, including farming C corporations, eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules apply to taxable years beginning after December 31, 2017. Application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

The proposal to expand the exception for small construction contracts from the requirement to use the percentage-of-completion method applies to contracts entered into after December 31, 2017, in taxable years ending after such date. Application of this rule is a change in the taxpayer's method of accounting for purposes of section 481. Application of the exception for small construction contracts from the requirement to use the percentage-of-completion

[368] Consistent with present law, a deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations. See Treas. Reg. sec. 1.162-3(a)(1).

[369] The taxpayer's financial accounting treatment of inventories is determined by reference to the method of accounting used in the taxpayer's applicable financial statement (as defined in section 3202 of the bill (Small business accounting method reform and simplification)) or, if the taxpayer does not have an applicable financial statement, the method of accounting used in the taxpayer's book and records prepared in accordance with the taxpayer's accounting procedures.

[370] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

[371] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

method is applied on a cutoff basis for all similarly classified contracts (hence there is no adjustment under section 481(a) for contracts entered into before January 1, 2018).

3. Small business exception from limitation on deduction of business interest

For present law, description of proposal, and effective date for the small business exception from the limitation on the deduction of business interest, see section 3301 of the bill (Interest).

D. Reform of Business-related Exclusions, Deductions, etc.

1. Interest

Present Law

Interest deduction

Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations.[372]

Interest is generally deducted by a taxpayer as it is paid or accrued, depending on the taxpayer's method of accounting. For all taxpayers, if an obligation is issued with original issue discount ("OID"), a deduction for interest is allowable over the life of the obligation on a yield to maturity basis.[373] OID arises where the amount to be paid at maturity exceeds the issue price by more than a *de minimis* amount.

Investment interest expense

In the case of a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment ("investment interest") is limited to the taxpayer's net investment income for the taxable year.[374] Disallowed investment interest is carried forward to the next taxable year.

Net investment income is investment income net of investment expenses. Investment income generally consists of gross income from property held for investment, and investment expense includes all deductions directly connected with the production of investment income (*e.g.*, deductions for investment management fees) other than deductions for interest. Investment income includes only so much of the taxpayer's net capital gain and qualified dividend income as the taxpayer elects to take into account as investment income.

The two-percent floor on miscellaneous itemized deductions allows taxpayers to deduct investment expenses connected with investment income only to the extent such deductions

[372] Sec. 163(a). In addition to the limitations discussed herein, other limitations include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for personal interest (sec. 163(h)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264), and disallowance of deduction for interest relating to tax-exempt income (sec. 265). Interest may also be subject to capitalization. See, *e.g.*, sections 263A(f) and 461(g).

[373] Sec. 163(e). But see section 267 (dealing in part with interest paid to a related or foreign party).

[374] Sec. 163(d).

exceed two percent of the taxpayer's adjusted gross income ("AGI").[375] Miscellaneous itemized deductions[376] that are not investment expenses are disallowed first before any investment expenses are disallowed.[377]

For purposes of the investment interest limitation, debt is allocated under a tracing approach to expenditures in accordance with the use of the debt proceeds, and interest on the debt is allocated in the same manner.[378] Thus, generally, the disallowance of a deduction for investment interest depends on the individual's use of the proceeds of the debt. For example, if an individual pledges corporate stock held for investment as security for a loan and uses the debt proceeds to purchase a car for personal use, interest expense on the debt is allocated to the personal expenditure to purchase the car and is treated as nondeductible personal interest rather than investment interest.

Earnings stripping

Section 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a taxable year if two threshold tests are satisfied: the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio) and the payor's net interest expense exceeds 50 percent of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Disqualified interest includes interest paid or accrued to: (1) related parties when no Federal income tax is imposed with respect to such interest;[379] (2) unrelated parties in certain instances in which a related party guarantees the debt; or (3) to a real estate investment trust ("REIT") by a taxable REIT subsidiary of that trust.[380] Interest amounts disallowed under these rules can be carried forward indefinitely.[381] In addition, any

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[375] Sec. 67(a).

[376] Miscellaneous itemized deductions include itemized deductions of individuals other than certain specific itemized deductions. Sec. 67(b). Miscellaneous itemized deductions generally include, for example, investment management fees and certain employee business expenses, but specifically do not include, for example, interest, taxes, casualty and theft losses, charitable contributions, medical expenses, or other listed itemized deductions.

[377] H.R. Rep. No. 841, 99th Cong., 2d Sess., p. II-154, Sept. 18, 1986 (Conf. Rep.) ("In computing the amount of expenses that exceed the 2-percent floor, expenses that are not investment expenses are intended to be disallowed before any investment expenses are disallowed.").

[378] Temp. Treas. Reg. sec. 1.163-8T(c).

[379] If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

[380] Sec. 163(j)(3).

[381] Sec. 163(j)(1)(B).

excess limitation (*i.e.*, the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.[382]

Description of Proposal

In general

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of business interest income plus 30 percent of the adjusted taxable income of the taxpayer for the taxable year. The amount of any interest not allowed as a deduction for any taxable year may be carried forward for up to five years beyond the year in which the business interest was paid or accrued, treating business interest as allowed as a deduction on a first-in, first-out basis. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, it applies at the consolidated tax return filing level.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the proposal. Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of section 163(d).

By including business interest income in the limitation, the rule operates to limit the deduction for net interest expense to 30 percent of adjusted taxable income. That is, a deduction for business interest is permitted to the full extent of business interest income. To the extent that business interest exceeds business interest income, the deduction for the net interest expense is limited to 30 percent of adjusted taxable income.

Adjusted taxable income means the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion. The Secretary may provide other adjustments to the computation of adjusted taxable income.

Application to pass-through entities

In general

In the case of any partnership, the limitation is applied at the partnership level. Any deduction for business interest is taken into account in determining the nonseparately stated taxable income or loss of the partnership.[383] To prevent double counting, special rules are provided for the determination of the adjusted taxable income of each partner of the partnership.

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[382] Sec. 163(j)(2)(B)(ii).

[383] This amount is the "Ordinary business income or loss" reflected on Form 1065 (U.S. Return of Partnership Income). The partner's distributive share is reflected in Box 1 of Schedule K-1 (Form 1065).

Similarly, to allow for additional interest deduction by a partner in the case of an excess amount of unused adjusted taxable income limitation of the partnership, special rules apply. Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule

The adjusted taxable income of each partner (or shareholder, as the case may be) is determined without regard to such partner's distributive share of the nonspearately stated income or loss of such partnership. In the absence of such a rule, the same dollars of adjusted taxable income of a partnership could generate additional interest deductions as the income is passed through to the partners.

Example 1.−ABC is a partnership owned 50-50 by XYZ Corporation and an individual. ABC generates $200 of noninterest income. Its only expense is $60 of business interest. Under the proposal the deduction for business interest is limited to 30 percent of adjusted taxable income, that is, 30 percent * $200 = $60. ABC deducts $60 of business interest and reports ordinary business income of $140. XYZ's distributive share of the ordinary business income of ABC is $70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of $25. In the absence of any special rule, the $70 of taxable income from its interest in ABC would permit the deduction of up to an additional $21 of interest (30 percent * $70 = $21), resulting in a deduction disallowance of only $4. XYZ's $100 share of ABC's adjusted taxable income would generate $51 of interest deductions. If XYZ were instead a pass-through entity, additional deductions could be available at each tier.

The double counting rule provides that XYZ has adjusted taxable income computed without regard to the $70 distributive share of the nonspearately stated income of ABC. As a result it has adjusted taxable income of $0. XYZ's deduction for business interest is limited to 30 percent * $0 = $0, resulting in a deduction disallowance of $25.

Additional deduction limit

The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess amount of unused adjusted taxable income limitation. The excess amount with respect to any partnership is the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership exceeds the business interest income of the partnership. This allows a partner of a partnership to deduct more interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest.

Example 2.−The facts are the same as in Example 1 except ABC has only $40 of business interest but $20 of other deductible expenses. As in Example 1, ABC has a limit on its interest deduction of $60. The excess amount for ABC is $60 - $40 = $20. XYZ's distributive share of the excess amount from ABC partnership is $10. XYZ's deduction for business interest is limited to 30 percent of its adjusted taxable income plus its distributive share of the excess amount from ABC partnership (30 percent * $0 + $10 = $10). As a result of the rule, XYZ may deduct $10 of business interest and has an interest deduction disallowance of $15.

Carryforward of disallowed business interest

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward for up to five years. Carryforwards are determined on a first-in, first-out basis.

A coordination rule is provided with the limitation on deduction of interest by domestic corporations in international financial reporting groups.[384] Whichever rule imposes the lower limitation on deduction of interest with respect to the taxable year (and therefore the greatest amount of interest to be carried forward) governs.

Any carryforward of disallowed interest is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382.

Exceptions

The limitation does not apply to any taxpayer that meets the $25 million gross receipts test of section 448(c), that is, if the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed $25 million.[385]

The trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. As a result, for example, the wages of an employee are not counted in the adjusted taxable income of the taxpayer for purposes of determining the limitation.

The limitation does not apply to a real property trade or business as defined in section 469(c)(7)(C). Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation.

The limitation does not apply to certain regulated public utilities. Specifically, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof is not treated as a trade or business for purposes of the limitation.

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[384] See section 4302 of the bill (Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group).

[385] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

2. Modification of net operating loss deduction

Present Law

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income.[386] In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[387] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[388]

Different carryback periods apply with respect to NOLs arising in different circumstances. Extended carryback periods are allowed for NOLs attributable to specified liability losses and certain casualty and disaster losses.[389] Limitations are placed on the carryback of excess interest losses attributable to corporate equity reduction transactions.[390]

Description of Proposal

The proposal limits the NOL deduction to 90 percent of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and may be carried forward indefinitely. In addition, NOL carryovers attributable to losses arising in taxable years beginning after December 31, 2017, are increased annually by an inflation adjustment.

The proposal repeals the two-year carryback and the special carryback provisions, but provides a one-year carryback in the case of certain disaster losses incurred in the trade or business of farming, or by certain small businesses.[391] For this purpose, small business means a corporation, partnership, or sole proprietorship whose average annual gross receipts for the three-

[386] Sec. 172(c).

[387] Sec. 172(b)(1)(A).

[388] Sec. 172(b)(2).

[389] Sec. 172(b)(1)(C) and (E).

[390] Sec. 172(b)(1)(D).

[391] Notwithstanding the amendments made by the proposal and section 1304 of the bill (Repeal of deduction for personal casualty losses), the proposal retains the present-law three-year carryback for the portion of the NOL for any taxable year which is a net disaster loss to which section 504(b) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (Pub. L. No. 115-63) applies (*i.e.*, a net disaster loss arising from hurricane Harvey, Irma, or Maria).

taxable-year period ending with such taxable year does not exceed $5,000,000. Aggregation rules apply to determine gross receipts.

Effective Date

The proposal allowing indefinite carryovers and modifying carrybacks generally applies to losses arising in taxable years beginning after December 31, 2017.[392]

The proposal limiting the NOL deduction applies to taxable years beginning after December 31, 2017.

The annual increase in carryover amounts applies to taxable years beginning after December 31, 2017.

3. Like-kind exchanges of real property

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" which is to be held for productive use in a trade or business or for investment.[393] In general, section 1031 does not apply to any exchange of stock in trade (*i.e.*, inventory) or other property held primarily for sale; stocks, bonds, or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[394] Section 1031 also does not apply to certain exchanges involving livestock[395] or foreign property.[396]

For purposes of section 1031, the determination of whether property is of a "like kind" relates to the nature or character of the property and not its grade or quality, *i.e.*, the nonrecognition rules do not apply to an exchange of one class or kind of property for property of a different class or kind (*e.g.*, section 1031 does not apply to an exchange of real property for personal property).[397] The different classes of property are: (1) depreciable tangible personal

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[392] See section 3101 of the bill (Increased expensing) for a limitation on the amount of any NOL which may be treated as an NOL carryback in the case of any year which includes any portion of the period beginning September 28, 2017, and ending December 31, 2017.

[393] Sec. 1031(a)(1).

[394] Sec. 1031(a)(2). A chose in action is a right that can be enforced by legal action.

[395] Sec. 1031(e).

[396] Sec. 1031(h).

[397] Treas. Reg. sec. 1.1031(a)-1(b).

property;[398] (2) intangible or nondepreciable personal property;[399] and (3) real property.[400] However, the rules with respect to whether real estate is "like kind" are applied more liberally than the rules governing like-kind exchanges of depreciable, intangible, or nondepreciable personal property. For example, improved real estate and unimproved real estate generally are considered to be property of a "like kind" as this distinction relates to the grade or quality of the real estate,[401] while depreciable tangible personal properties must be either within the same General Asset Class[402] or within the same Product Class.[403]

The nonrecognition of gain in a like-kind exchange applies only to the extent that like-kind property is received in the exchange. Thus, if an exchange of property would meet the requirements of section 1031, but for the fact that the property received in the transaction consists not only of the property that would be permitted to be exchanged on a tax-free basis, but also other non-qualifying property or money ("additional consideration"), then the gain to the recipient of the other property or money is required to be recognized, but not in an amount

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[398] For example, an exchange of a personal computer classified under asset class 00.12 of Rev. Proc. 87-56, 1987-2 C.B. 674, for a printer classified under the same asset class of Rev. Proc. 87-56 would be treated as property of a like kind. However, an exchange of an airplane classified under asset class 00.21 of Rev. Proc. 87-56 for a heavy general purpose truck classified under asset class 00.242 of Rev. Proc. 87-56 would not be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)-2(b)(7).

[399] For example, an exchange of a copyright on a novel for a copyright on a different novel would be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)-2(c)(3). However, the goodwill or going concern value of one business is not of a like kind to the goodwill or going concern value of a different business. See Treas. Reg. sec. 1.1031(a)-2(c)(2). The Internal Revenue Service ("IRS") has ruled that intangible assets such as trademarks, trade names, mastheads, and customer-based intangibles that can be separately described and valued apart from goodwill qualify as property of a like kind under section 1031. See Chief Counsel Advice 200911006, February 12, 2009.

[400] Treas. Reg. sec. 1.1031(a)-1(b) and (c).

[401] Treas. Reg. sec. 1.1031(a)-1(b).

[402] Treasury Regulation section 1.1031(a)-2(b)(2) provides the following list of General Asset Classes, based on asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87-56, 1987-2 C.B. 674: (i) Office furniture, fixtures, and equipment (asset class 00.11), (ii) Information systems (computers and peripheral equipment) (asset class 00.12), (iii) Data handling equipment, except computers (asset class 00.13), (iv) Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21), (v) Automobiles, taxis (asset class 00.22), (vi) Buses (asset class 00.23), (vii) Light general purpose trucks (asset class 00.241), (viii) Heavy general purpose trucks (asset class 00.242), (ix) Railroad cars and locomotives, except those owned by railroad transportation companies (asset class 00.25), (x) Tractor units for use over-the-road (asset class 00.26), (xi) Trailers and trailer-mounted containers (asset class 00.27), (xii) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction (asset class 00.28), and (xiii) Industrial steam and electric generation and/or distribution systems (asset class 00.4).

[403] Property within a product class consists of depreciable tangible personal property that is described in a 6-digit product class within Sectors 31, 32, and 33 (pertaining to manufacturing industries) of the North American Industry Classification System ("NAICS"), set forth in Executive Office of the President, Office of Management and Budget, *North American Industry Classification System*, United States, 2002 (NAICS Manual), as periodically updated. Treas. Reg. sec. 1.1031(a)-2(b)(3).

exceeding the fair market value of such other property or money.[404] Additionally, any such gain realized on a section 1031 exchange as a result of additional consideration being involved constitutes ordinary income to the extent that the gain is subject to the recapture provisions of sections 1245 and 1250.[405] No losses may be recognized from a like-kind exchange.[406]

If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred. This basis is increased to the extent of any gain recognized as a result of the receipt of other property or money in the like-kind exchange, and decreased to the extent of any money received by the taxpayer.[407] The holding period of qualifying property received includes the holding period of the qualifying property transferred, but the nonqualifying property received is required to begin a new holding period.[408]

A like-kind exchange also does not require that the properties be exchanged simultaneously. Rather, the property to be received in the exchange must be received not more than 180 days after the date on which the taxpayer relinquishes the original property (but in no event later than the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the transfer of the relinquished property occurs). In addition, the taxpayer must identify the property to be received within 45 days after the date on which the taxpayer transfers the property relinquished in the exchange.[409]

The Treasury Department has issued regulations[410] and revenue procedures[411] providing guidance and safe harbors for taxpayers engaging in deferred like-kind exchanges.

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[404] Sec. 1031(b). For example, if a taxpayer holding land A having a basis of $40,000 and a fair market value of $100,000 exchanges the property for land B worth $90,000 plus $10,000 in cash, the taxpayer would recognize $10,000 of gain on the transaction, which would be includable in income. The remaining $50,000 of gain would be deferred until the taxpayer disposes of land B in a taxable sale or exchange.

[405] Secs. 1245(b)(4) and 1250(d)(4). For example, if a taxpayer holding section 1245 property A with an original cost basis of $11,000, an adjusted basis of $10,000, and a fair market value of $15,000 exchanges the property for section 1245 property B with a fair market value of $14,000 plus $1,000 in cash, the taxpayer would recognize $1,000 of ordinary income on the transaction. The remaining $4,000 of gain would be deferred until the taxpayer disposes of section 1245 property B in a taxable sale or exchange.

[406] Sec. 1031(c).

[407] Sec. 1031(d). Thus, in the example noted above, the taxpayer's basis in B would be $40,000 (the taxpayer's transferred basis of $40,000, increased by $10,000 in gain recognized, and decreased by $10,000 in money received).

[408] Sec. 1223(1).

[409] Sec. 1031(a)(3).

[410] Treas. Reg. sec. 1.1031(k)-1(a) through (o).

[411] See Rev. Proc. 2000-37, 2000-40 I.R.B. 308, as modified by Rev. Proc. 2004-51, 2004-33 I.R.B. 294.

Description of Proposal

The proposal modifies the provision providing for nonrecognition of gain in the case of like-kind exchanges by limiting its application to real property that is not held primarily for sale.

Effective Date

The proposal generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before such date.

4. Revision of treatment of contributions to capital

Present Law

The gross income of a corporation does not include any contribution to its capital.[412] For purposes of this rule, a contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution from a customer or potential customer.[413] A special rule allows certain contributions in aid of construction received by a regulated public utility that provides water or sewerage disposal services to be treated as a tax-free contribution to the capital of the utility.[414] No deduction or credit is allowed for, or by reason of, any expenditure that constitutes a contribution that is treated as a tax-free contribution to the capital of the utility.[415]

If property is acquired by a corporation as a contribution to capital and is not contributed by a shareholder as such, the adjusted basis of the property is zero.[416] If the contribution consists of money, the corporation must first reduce the basis of any property acquired with the contributed money within the following 12-month period, and then reduce the basis of other property held by the corporation.[417] Similarly, the adjusted basis of any property acquired by a utility with a contribution in aid of construction is zero.[418]

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412 Sec. 118(a).

413 Sec. 118(b).

414 Sec. 118(c)(1).

415 Sec. 118(c)(4).

416 Sec. 362(c)(1).

417 Sec. 362(c)(2). See also Treas. Reg. sec. 1.362-2.

418 Sec. 118(c)(4).

Description of Proposal

The proposal repeals the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions of capital to the corporation.

Further, the proposal provides that a contribution to capital, other than a contribution of money or property made in exchange for stock of a corporation or any interest in an entity, is included in gross income of a taxpayer. For example, a contribution of municipal land by a municipality that is not in exchange for stock (or for a partnership interest or other interest) of equivalent value is considered a contribution to capital that is includable in gross income. By contrast, a municipal tax abatement for locating a business in a particular municipality is not considered a contribution to capital.

The proposal also provides rules clarifying the contributee's basis in the property contributed.

Effective Date

The proposal applies to contributions made, and transactions entered into, after the date of enactment.

5. Repeal of deduction for local lobbying expenses

Present Law

In general

A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[419] However, section 162(e) denies a deduction for amounts paid or incurred in connection with (1) influencing legislation,[420] (2) participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office, (3) any attempt to influence the general public, or segments thereof, with respect to elections, legislative matters, or referendums, or (4) any direct communication with a covered executive branch official[421] in an attempt to influence the official actions or positions of such

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[419] Sec. 162(a).

[420] The term "influencing legislation" means any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation. The term "legislation" includes actions with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. Secs. 162(e)(4) and 4911(e)(2).

[421] The term "covered executive branch official" means (1) the President, (2) the Vice President, (3) any officer or employee of the White House Office of the Executive Office of the President, and the two most senior level officers of each of the other agencies in such Executive Office, (4) any individual servicing in a position in level I of the Executive Schedule under section 5312 of title 5, United States Code, (5) any other individual

official. Expenses paid or incurred in connection with lobbying and political activities (such as research for, or preparation, planning, or coordination of, any previously described activity) also are not deductible.[422]

Exceptions

Local legislation

Notwithstanding the above, a deduction is allowed for ordinary and necessary expenses incurred in connection with any legislation of any local council or similar governing body ("local legislation").[423] With respect to local legislation, the exception permits a deduction for amounts paid or incurred in carrying on any trade or business (1) in direct connection with appearances before, submission of statements to, or sending communications to the committees or individual members of such council or body with respect to legislation or proposed legislation of direct interest to the taxpayer, or (2) in direct connection with communication of information between the taxpayer and an organization of which the taxpayer is a member with respect to any such legislation or proposed legislation which is of direct interest to the taxpayer and such organization, and (3) that portion of the dues paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities described in (1) or (2) carried on by such organization.[424]

For purposes of this exception, legislation of an Indian tribal government is treated in the same manner as local legislation.[425]

De minimis

For taxpayers with $2,000 or less of in-house expenditures related to lobbying and political activities, a de minimis exception is provided that permits a deduction.[426]

Description of Proposal

The proposal repeals the exception for amounts paid or incurred related to lobbying local councils or similar governing bodies, including Indian tribal governments. Thus, the general

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designated by the President as having Cabinet-level status, and (6) any immediate deputy of an individual described in (4) or (5). Sec. 162(e)(6).

422 Sec. 162(e)(5)(C).

423 Sec. 162(e)(2)(A).

424 Sec. 162(e)(2)(B).

425 Sec. 162(e)(7).

426 Sec. 162(e)(5)(B).

disallowance rules applicable to lobbying and political expenditures will apply to costs incurred related to such local legislation.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017.

6. Repeal of deduction for income attributable to domestic production activities

Present Law

Section 199 provides a deduction from taxable income (or, in the case of an individual, adjusted gross income[427]) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income (determined without regard to the section 199 deduction) for the taxable year.[428] For corporations subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.[429] A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.[430]

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[431] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States;[432] (2) any sale, exchange, or

[427] For this purpose, adjusted gross income is determined after application of sections 86, 135, 137, 219, 221, 222, and 469, without regard to the section 199 deduction. Sec. 199(d)(2).

[428] Sec. 199(a). In the case of oil related qualified production activities income, the deduction from taxable income is equal to six percent of the lesser of the taxpayer's oil related qualified production activities income, qualified production activities income, or taxable income. Sec. 199(d)(9).

[429] This example assumes the deduction does not exceed the wage limitation discussed below.

[430] Sec. 199(c)(1). In computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction. Sec. 199(c)(1)(B)(ii). See Treas. Reg. secs. 1.199-1 through 1.199-9 where the Secretary has prescribed rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income.

[431] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings. Sec. 199(c)(5).

[432] When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia. Sec. 7701(a)(9). A special rule for determining domestic production gross receipts, however, provides that for taxable years beginning after December 31, 2005, and before January 1, 2018, in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term

other disposition, or any lease, rental, or license, of qualified film[433] produced by the taxpayer; (3) any sale, exchange, or other disposition, or any lease, rental, or license, of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.[434]

The amount of the deduction for a taxable year is limited to 50 percent of the W-2 wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[435]

Description of Proposal

The proposal repeals the deduction for income attributable to domestic production activities.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

"United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations for such taxable year. Secs. 199(d)(8)(A) and (C), as extended by section 4401 of the bill (Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico). In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico. Sec. 199(d)(8)(B).

[433] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers. Sec. 199(c)(6).

[434] Sec. 199(c)(4)(A).

[435] Sec. 199(b)(1). For purposes of the provision, "W-2 wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions as defined in section 402A. See sec. 199(b)(2)(A). The wage limitation for qualified films includes any compensation for services performed in the United States by actors, production personnel, directors, and producers and is not restricted to W-2 wages. Sec. 199(b)(2)(D).

7. Entertainment, etc. expenses

Present Law

In general

No deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation ("entertainment"), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (*e.g.*, an airplane) used in connection with such activity.[436] If the taxpayer establishes that entertainment expenses are directly related to (or associated with) the active conduct of its trade or business, the deduction generally is limited to 50 percent of the amount otherwise deductible.[437] Similarly, a deduction for any expense for food or beverages generally is limited to 50 percent of the amount otherwise deductible.[438] In addition, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation, or other social purpose.[439]

There are a number of exceptions to the general rule disallowing deduction of entertainment expenses and the rules limiting deductions to 50 percent of the otherwise deductible amount. Under one such exception, those rules do not apply to expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and as wages to an employee.[440] Those rules also do not apply to expenses for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient who is not an employee (*e.g.*, a nonemployee director) as compensation for services rendered or as a prize or award.[441] The exceptions apply only to the extent that amounts are properly reported by the company as compensation and wages or otherwise includible in income. In no event can the amount of the deduction exceed the amount of the taxpayer's actual cost, even if a greater amount (*i.e.*, fair market value) is includible in income.[442]

Those deduction disallowance rules also do not apply to expenses paid or incurred by the taxpayer, in connection with the performance of services for another person (other than an employer), under a reimbursement or other expense allowance arrangement if the taxpayer

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[436] Sec. 274(a)(1).

[437] Sec. 274(n)(1)(B).

[438] Sec. 274(n)(1)(A).

[439] Sec. 274(a)(3).

[440] Sec. 274(e)(2)(A). See below for a discussion of the recent modification of this rule for certain individuals.

[441] Sec. 274(e)(9).

[442] Treas. Reg. sec. 1.162-25T(a).

accounts for the expenses to such person.[443] Another exception applies for expenses for recreational, social, or similar activities primarily for the benefit of employees other than certain owners and highly compensated employees.[444] An exception applies also to the 50 percent deduction limit for food and beverages provided to crew members of certain commercial vessels and certain oil or gas platform or drilling rig workers.[445]

Expenses treated as compensation

Except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.[446] In general, an employee (or other service provider) must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount (if any) paid by the individual and the amount (if any) specifically excluded from gross income.[447] Treasury regulations provide detailed rules regarding the valuation of certain fringe benefits, including flights on an employer-provided aircraft. In general, the value of a non-commercial flight generally is determined under the base aircraft valuation formula, also known as the Standard Industry Fare Level formula or "SIFL."[448] If the SIFL valuation rules do not apply, the value of a flight on an employer-provided aircraft generally is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable aircraft for that period for the same or a comparable flight.[449]

In the context of an employer providing an aircraft to employees for nonbusiness (*e.g.*, vacation) flights, the exception for expenses treated as compensation has been interpreted as not limiting the company's deduction for expenses attributable to the operation of the aircraft to the amount of compensation reportable to its employees.[450] The result of that interpretation is often a deduction several times larger than the amount required to be included in income. Further, in many cases, the individual including amounts attributable to personal travel in income directly benefits from the enhanced deduction, resulting in a net deduction for the personal use of the company aircraft.

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[443] Sec. 274(e)(3).

[444] Sec. 274(e)(4).

[445] Sec. 274(n)(2)(E).

[446] Sec. 61(a)(1).

[447] Treas. Reg. sec. 1.61-21(b)(1).

[448] Treas. Reg. sec. 1.61-21(g)(5).

[449] Treas. Reg. sec. 1.61-21(b)(6).

[450] *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 197 (2000), aff'd, 255 F.3d 495 (8th Cir. 2001).

The exceptions for expenses treated as compensation or otherwise includible income were subsequently modified in the case of specified individuals such that the exceptions apply only to the extent of the amount of expenses treated as compensation or includible in income of the specified individual.[451] Specified individuals are individuals who, with respect to an employer or other service recipient (or a related party), are subject to the requirements of section 16(a) of the Securities Exchange Act of 1934, or would be subject to such requirements if the employer or service recipient (or related party) were an issuer of equity securities referred to in section 16(a).[452]

As a result, in the case of specified individuals, no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (*e.g.*, an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income to the specified individual. For example, a company's deduction attributable to aircraft operating costs and other expenses for a specified individual's vacation use of a company aircraft is limited to the amount reported as compensation to the specified individual. However, in the case of other employees or service providers, the company's deduction is not limited to the amount treated as compensation or includible in income.[453]

Excludable fringe benefits

Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including de minimis fringes and qualified transportation fringes.[454] A de minimis fringe generally means any property or service the value of which is (taking into account the frequency with which similar fringes are provided by the employer) so small as to make accounting for it unreasonable or administratively impracticable.[455] Qualified transportation fringes include qualified parking (*i.e.*, on or near the employer's business premises or on or near a location from which the employee commutes to work by public transit), transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.[456] On-premises athletic facilities are gyms or other athletic facilities located on

[451] Sec. 274(e)(2)(B)(i). See also Treas. Reg. sec. 1.274-9(a).

[452] Sec. 274(e)(2)(B)(ii). See also Treas. Reg. sec. 1.274-9(b).

[453] See Treas. Reg. sec. 1.274-10(a)(2).

[454] Secs. 132(a), 3121(a)(20), 3231(e)(5), 3306(b)(16), and 3401(a)(19).

[455] Sec. 132(e)(1). Examples include occasional personal use of an employer's copying machine, occasional parties or meals for employees and their guests, local telephone calls, and coffee, doughnuts and soft drinks. Treas. Reg. sec. 1.132-6(e)(1).

[456] Sec. 132(f)(1), (5). The qualified transportation fringe exclusions are subject to monthly limits. Sec. 132(f)(2).

the employer's premises, operated by the employer, and substantially all the use of which is by employees of the employer, their spouses, and their dependent children.[457]

Description of Proposal

The proposal provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, (3) a de minimis fringe that is primarily personal in nature and involving property or services that are not directly related to the taxpayer's trade or business, (4) a facility or portion thereof used in connection with any of the above items, (5) a qualified transportation fringe, including costs of operating a facility used for qualified parking, and (6) an on-premises athletic facility provided by an employer to its employees, including costs of operating such a facility. Thus, the proposal repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions). The proposal also repeals the present-law exception for recreational, social, or similar activities primarily for the benefit of employees. However, taxpayers may still, generally, deduct 50 percent of the food and beverage expenses associated with operating their trade or business (*e.g.*, meals consumed by employees on work travel).

Under the proposal, in the case of all individuals (not just specified individuals), the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income. Thus, under those exceptions, no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (*e.g.*, an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income. As under present law, the exceptions apply only if amounts are properly reported by the company as compensation and wages or otherwise includible in income.

The proposal amends the present-law exception for reimbursed expenses. The proposal disallows a deduction for amounts paid or incurred by a taxpayer in connection with the performance of services for another person (other than an employee) under a reimbursement or other expense allowance arrangement if the person for whom the services are performed is a tax-exempt entity[458] or the arrangement is designated by the Secretary as having the effect of avoiding the 50 percent deduction disallowance.

The proposal clarifies that the exception to the 50 percent deduction limit for food or beverages applies to any expense excludible from the gross income of the recipient related to meals furnished for the convenience of the employer. The proposal thereby repeals as deadwood

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[457] Section 132(j)(4).

[458] As defined in section 168(h)(2)(A), *i.e.*, Federal, State and local government entities, organizations (other than certain cooperatives) exempt from income tax, any foreign person or entity, and any Indian tribal government.

the special exceptions for food or beverages provided to crew members of certain commercial vessels and certain oil or gas platform or drilling rig workers.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017.

8. Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[459] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing its exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[460] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income deductions directly connected with the unrelated trade or business.[461] Under regulations, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses aggregates income from all

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[459] Secs. 511-514.

[460] Treas. Reg. sec. 1.501(c)(3)-1(e).

[461] Sec. 512(a).

such activities and subtracts from the aggregate gross income the aggregate of deductions.[462] As a result, an organization may use a loss from one unrelated trade or business to offset gain from another, thereby reducing total unrelated business taxable income.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts); (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a); and (3) certain State colleges and universities.[463]

Exclusions from Unrelated Business Taxable Income

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[464] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[465] Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Description of Proposal

Under the proposal, unrelated business taxable income includes any expenses paid or incurred by a tax exempt organization for qualified transportation fringe benefits (as defined in section 132(f)), a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)), provided such amounts are not deductible under section 274.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017.

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[462] Treas. Reg. sec. 1.512(a)-1(a).

[463] Sec. 511(a)(2).

[464] Secs. 511-514.

[465] Sec. 512(b)(13).

9. Limitation on deduction for FDIC premiums

Present Law

Corporations organized under the laws of any of the 50 States (and the District of Columbia) generally are subject to the U.S. corporate income tax on their worldwide taxable income. The taxable income of a C corporation[466] generally comprises gross income less allowable deductions. A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[467]

Corporations that make a valid election pursuant to section 1362 of subchapter S of the Code, referred to as S corporations, generally are not subject to corporate-level income tax on its items of income and loss. Instead, an S corporation passes through to shareholders its items of income and loss. The shareholders separately take into account their shares of these items on their individual income tax returns.

Banks, thrifts, and credit unions

In general

Financial institutions are subject to the same Federal income tax rules and rates as are applied to other corporations or entities, with specified exceptions.

C corporation banks and thrifts

A bank is generally taxed for Federal income tax purposes as a C corporation. For this purpose a bank generally means a corporation, a substantial portion of whose business is receiving deposits and making loans and discounts, or exercising certain fiduciary powers.[468] A

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[466] Corporations subject to tax are commonly referred to as C corporations after subchapter C of the Code, which sets forth corporate tax rules. Certain specialized entities that invest primarily in real estate related assets (real estate investment trusts) or in stock and securities (regulated investment companies) and that meet other requirements, generally including annual distribution of 90 percent of their income, are allowed to deduct their distributions to shareholders, thus generally paying little or no corporate-level tax despite otherwise being subject to subchapter C.

[467] Sec. 162(a). However, certain exceptions apply. No deduction is allowed for (1) any charitable contribution or gift that would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section; (2) any illegal bribe, illegal kickback, or other illegal payment; (3) certain lobbying and political expenditures; (4) any fine or similar penalty paid to a government for the violation of any law; (5) two-thirds of treble damage payments under the antitrust laws; (6) certain foreign advertising expenses; (7) certain amounts paid or incurred by a corporation in connection with the reacquisition of its stock or of the stock of any related person; or (8) certain applicable employee remuneration.

[468] Sec. 581. See also Treas. Reg. sec. 1.581-1(a).

bank for this purpose generally includes domestic building and loan associations, mutual stock or savings banks, and certain cooperative banks that are commonly referred to as thrifts.[469]

S corporation banks

A bank is generally eligible to elect S corporation status under section 1362, provided it meets the other requirements for making this election and it does not use the reserve method of accounting for bad debts as described in section 585.[470]

Special bad debt loss rules for small banks

Section 166 provides a deduction for any debt that becomes worthless (wholly or partially) within a taxable year. The reserve method of accounting for bad debts, repealed in 1986[471] for most taxpayers, is allowed under section 585 for any bank (as defined in section 581) other than a large bank. For this purpose, a bank is a large bank if, for the taxable year (or for any preceding taxable year after 1986), the average adjusted basis of all its assets (or the assets of the controlled group of which it is a member) exceeds $500 million. Deductions for reserves are taken in lieu of a worthless debt deduction under section 166. Accordingly, a small bank is able to take deductions for additions to a bad debt reserve. Additions to the reserve are determined under an experience method that generally looks to the ratio of (1) the total bad debts sustained during the taxable year and the five preceding taxable years to (2) the sum of the loans outstanding at the close of such taxable years.[472]

Credit unions

Credit unions are exempt from Federal income taxation.[473] The exemption is based on their status as not-for-profit mutual or cooperative organizations (without capital stock) operated for the benefit of their members, who generally must share a common bond. The definition of common bond has been expanded to permit greater use of credit unions.[474] While significant

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469 While the general principles for determining the taxable income of a corporation are applicable to a mutual savings bank, a building and loan association, and a cooperative bank, there are certain exceptions and special rules for such institutions. Treas. Reg. sec. 1.581-2(a).

470 Sec. 1361(b)(2)(A).

471 Tax Reform Act of 1986, Pub. L. No. 99-514.

472 Sec. 585(b)(2).

473 Sec. 501(c)(14)(A). For a discussion of the history of and reasons for Federal tax exemption, see United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions,* Report 3070, January 15, 2001, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

474 The Credit Union Membership Access Act, Pub. L. No. 105-219, allows multiple common bond credit unions. The legislation in part responds to *National Credit Union Administration v. First National Bank & Trust Co.*, 522 U.S. 479 (1998), which interpreted the permissible membership of tax-exempt credit unions narrowly.

differences between the rules under which credit unions and banks operate have existed in the past, most of those differences have disappeared over time.[475]

FDIC premiums

The Federal Deposit Insurance Corporation ("FDIC") provides deposit insurance for banks and savings institutions. To maintain its status as an insured depository institution, a bank must pay semiannual assessments into the deposit insurance fund. Assessments for deposit insurance are treated as ordinary and necessary business expenses. These assessments, also known as premiums, are deductible once the all events test for the premium is satisfied.[476]

Description of Proposal

No deduction is allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer. For taxpayers with total consolidated assets of $50 billion or more, the applicable percentage is 100 percent. Otherwise, the applicable percentage is the ratio of the excess of total consolidated assets over $10 billion to $40 billion. For example, for a taxpayer with total consolidated assets of $20 billion, no deduction is allowed for 25 percent of FDIC premiums. The proposal does not apply to taxpayers with total consolidated assets (as of the close of the taxable year) that do not exceed $10 billion.

FDIC premium means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act.[477] The term total consolidated assets has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[478]

For purposes of determining a taxpayer's total consolidated assets, members of an expanded affiliated group are treated as a single taxpayer. An expanded affiliated group means an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to the exceptions from the definition of includible corporation for insurance companies and foreign corporations. A partnership or any other entity other than a corporation is treated as a member of an expanded affiliated group if such entity is controlled by members of such group.

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[475] The Treasury Department has concluded that any remaining regulatory differences do not raise competitive equity concerns between credit unions and banks. United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions,* Report 3070, January 15, 2001, p. 2, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

[476] Technical Advice Memorandum 199924060, March 5, 1999, and Rev. Rul. 80-230, 1980-2 C.B. 169, 1980.

[477] 12 U.S.C. sec. 1817(b).

[478] Pub. L. No. 111-203.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

10. Repeal of rollover of publicly traded securities gain into specialized small business investment companies

Present Law

A corporation or individual may elect to roll over tax-free any capital gain realized on the sale of publicly-traded securities to the extent of the taxpayer's cost of purchasing common stock or a partnership interest in a specialized small business investment company within 60 days of the sale.[479] The amount of gain that an individual may elect to roll over under this provision for a taxable year is limited to (1) $50,000 or (2) $500,000 reduced by the gain previously excluded under this provision.[480] For corporations, these limits are $250,000 and $1 million, respectively.[481]

Description of Proposal

The proposal repeals the election to roll over capital gain realized on the sale of publicly-traded securities.

Effective Date

The proposal applies to sales after December 31, 2017.

11. Certain self-created property not treated as a capital asset

Present Law

In general, property held by a taxpayer (whether or not connected with his trade or business) is considered a capital asset.[482] Certain assets, however, are specifically excluded from the definition of capital asset. Such excluded assets are: inventory property, property of a character subject to depreciation (including real property),[483] certain self-created intangibles, accounts or notes receivable acquired in the ordinary course of business (*e.g.*, for providing

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[479] Sec. 1044(a).

[480] Sec. 1044(b)(1).

[481] Sec. 1044(b)(2).

[482] Sec. 1221(a).

[483] The net gain from the sale, exchange, or involuntary conversion of certain property used in the taxpayer's trade or business (in excess of depreciation recapture) is treated as long-term capital gain. Sec. 1231. However, net gain from such property is treated as ordinary income to the extent that losses from such property in the previous five years were treated as ordinary losses. Sec. 1231(c).

services or selling property), publications of the U.S. Government received by a taxpayer other than by purchase at the price offered to the public, commodities derivative financial instruments held by a commodities derivatives dealer unless established to the satisfaction of the Secretary that any such instrument has no connection to the activities of such dealer as a dealer and clearly identified as such before the close of the day on which it was acquired, originated, or entered into, hedging transactions clearly identified as such, and supplies regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.[484]

Self-created intangibles subject to the exception are copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property which is held either by the taxpayer who created the property, or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced.[485] For the purpose of determining gain, a taxpayer with a substituted or transferred basis from the taxpayer who created the property, or for whom the property was created, also is subject to the exception.[486] However, a taxpayer may elect to treat musical compositions and copyrights in musical works as capital assets.[487]

Since the intent of Congress is that profits and losses arising from everyday business operations be characterized as ordinary income and loss, the general definition of capital asset is narrowly applied and the categories of exclusions are broadly interpreted.[488]

Description of Proposal

This proposal amends section 1221(a)(3), resulting in the exclusion of a patent, invention, model or design (whether or not patented), a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) from the definition of a "capital asset." Thus, gains or losses from the sale or exchange of a patent, invention, model or design (whether or not patented), or a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) will not receive capital gain treatment.

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[484] Sec. 1221(a)(1)-(8).

[485] Sec. 1221(a)(3)(A) and (B).

[486] Sec. 1221(a)(3)(C).

[487] Sec. 1221(b)(3). Thus, if a taxpayer who owns musical compositions or copyrights in musical works that the taxpayer created (or if a taxpayer to which the musical compositions or copyrights have been transferred by the works' creator in a substituted basis transaction) elects the application of this provision, gain from a sale of the compositions or copyrights is treated as capital gain, not ordinary income.

[488] *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52 (1955).

The proposal also repeals the elective capital treatment for musical compositions and copyrights in musical works. Thus, gains or losses from the sale or exchange of musical compositions and copyrights in musical works will not receive capital gain treatment.

Effective Date

The proposal applies to dispositions after December 31, 2017.

12. Repeal of special rule for sale or exchange of patents

Present Law

Section 1235 provides that a transfer[489] of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than one year, regardless of whether or not payments in consideration of such transfer are (1) payable periodically over a period generally conterminous with the transferee's use of the patent, or (2) contingent on the productivity, use, or disposition of the property transferred.[490]

A holder is defined as (1) any individual whose efforts created such property, or (2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither the employer of such creator nor related (as defined) to such creator.[491]

Description of Proposal

The proposal repeals section 1235. Thus, the holder of a patented invention may not transfer his or her rights to the patent and treat amounts received as proceeds from the sale of a capital asset. It is intended that the determination of whether a transfer is a sale or exchange of a capital asset that produces capital gain, or a transaction that produces ordinary income, will be determined under generally applicable principles.[492]

Effective Date

The proposal applies to dispositions after December 31, 2017.

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[489] A transfer by gift, inheritance, or devise is not included.

[490] Sec. 1235(a).

[491] Sec. 1235(b).

[492] See also section 3311 of the bill (Certain self-created property not treated as a capital asset).

13. Repeal of technical termination of partnerships

Present Law

A partnership is considered as terminated under specified circumstances.[493] Special rules apply in the case of the merger, consolidation, or division of a partnership.[494]

A partnership is treated as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.[495]

A partnership is also treated as terminated if within any 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.[496] This is sometimes referred to as a technical termination. Under regulations, the technical termination gives rise to a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners.[497]

The effect of a technical termination is not necessarily the end of the partnership's existence, but rather the termination of some tax attributes. Upon a technical termination, the partnership's taxable year closes, potentially resulting in short taxable years.[498] Partnership-level elections generally cease to apply following a technical termination. A technical termination generally results in the restart of partnership depreciation recovery periods.

Description of Proposal

The proposal repeals the section 708(b)(1)(B) rule providing for technical terminations of partnerships. The proposal does not change the present-law rule of section 708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Effective Date

The proposal applies to partnership taxable years beginning after December 31, 2017.

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[493] Sec. 708(b)(1).

[494] Sec. 708(b)(2). Mergers, consolidations, and divisions of partnerships take either an assets-over form or an assets-up form pursuant to Treas. Reg. sec. 1.708-1(c).

[495] Sec. 708(b)(1)(A).

[496] Sec. 708(b)(1)(B).

[497] Treas. Reg. sec. 1.708-1(b)(4).

[498] Sec. 706(c)(1); Treas. Reg. sec. 1.708-1(b)(3).

E. Reform of Business Credits

1. Repeal of credit for clinical testing expenses for certain drugs for rare diseases or conditions

Present Law

Section 45C provides a 50-percent business tax credit for qualified clinical testing expenses incurred in testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified clinical testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration ("FDA") but before the drug has been approved for sale by the FDA.[499] A rare disease or condition is defined as one that (1) affects fewer than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for such disease or condition from sales in the United States of the drug.[500]

Amounts included in computing the credit under this section are excluded from the computation of the research credit under section 41.[501]

Description of Proposal

This proposal repeals the credit for qualified clinical testing expenses.

Effective Date

The proposal applies to amounts paid or incurred in taxable years beginning after December 31, 2017.

2. Repeal of employer-provided child care credit

Present Law

Taxpayers are eligible for a tax credit equal to 25 percent of qualified expenditures for employee child care and 10 percent of qualified expenditures for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer may not exceed $150,000 per taxable year. The credit is part of the general business credit.[502]

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[499] Sec. 45C(b).

[500] Sec. 45C(d).

[501] Sec. 45C(c).

[502] Sec. 38(b)(15).

Qualified child care expenditures generally include costs paid or incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer's qualified child care facility;[503] (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws.

Qualified child care expenditures for resource and referral services include amounts paid under contract to provide child care resource and referral services to a taxpayer's employees.

Description of Proposal

The proposal repeals the credit for qualified child care expenditures and qualified child care expenditures for resource and referral services.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Repeal of rehabilitation credit

Present Law

Section 47 provides a two-tier tax credit for rehabilitation expenditures.

A 20-percent credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure. For this purpose, a certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

A 10-percent credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. A pre-1936 building must meet requirements with respect to retention of existing external walls and internal structural framework of the building in order for expenditures with respect to it to qualify for the 10-percent credit. A building is treated as having met the substantial rehabilitation requirement under the 10-percent credit only if the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) $5,000.

[503] In addition, a depreciation deduction (or amortization in lieu of depreciation) must be allowable with respect to the property and the property must not be part of the principal residence of the taxpayer or any employee of the taxpayer.

The provision requires the use of straight-line depreciation or the alternative depreciation system in order for rehabilitation expenditures to be treated as qualified under the provision.

Description of Proposal

The proposal repeals the rehabilitation credit.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017. A transition rule provides that in the case of qualified rehabilitation expenditures (within the meaning of present law), with respect to any building owned or leased by the taxpayer at all times on and after January 1, 2018, the 24-month period selected by the taxpayer (under section 47(c)(1)(C)) is to begin not later than the end of the 180-day period beginning on the date of the enactment of the Act, and the amendments made by the proposal apply to such expenditures paid or incurred after the end of the taxable year in which such 24-month period ends.

4. Repeal of work opportunity tax credit

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of ten targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to services rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group. These targeted groups are: (1) Families receiving TANF; (2) Qualified veterans; (3) Qualified ex-felons; (4) Designated community residents; (5) Vocational rehabilitation referrals; (6) Qualified summer youth employees; (7) Qualified food and nutrition recipients; (8) Qualified SSI recipients; (9) Long-term family assistance recipients; and (10) Qualified long-term unemployment recipients.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in section 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups (except for long-term family assistance recipients and qualified veterans) equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

In the case of a qualified veterans, the credit is calculated as follows: (1) in the case of a qualified veteran who was eligible to receive assistance under a supplemental nutritional assistance program (for at least a three-month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one-year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

Expiration

The work opportunity tax credit is not available with respect to wages paid to individuals who begin work for an employer after December 31, 2019.

Description of Proposal

The proposal repeals the work opportunity tax credit.

Effective Date

The proposal applies to amounts paid or incurred to individuals who begin work for the employer after December 31, 2017.

5. Repeal of deduction for certain unused business credits

Present Law

The general business credit ("GBC") consists of various individual tax credits allowed with respect to certain qualified expenditures and activities.[504] In general, the various individual tax credits contain provisions that prohibit "double benefits," either by denying deductions in the case of expenditure-related credits or by requiring income inclusions in the case of activity-related credits. Unused credits may be carried back one year and carried forward 20 years.[505]

Section 196 allows a deduction to the extent that certain portions of the GBC expire unused after the end of the carry forward period. In general, 100 percent of the unused credit is allowed as a deduction in the taxable year after such credit expired. However, with respect to the investment credit determined under section 46 (other than the rehabilitation credit) and the research credit determined under section 41(a) (for a taxable year beginning before January 1, 1990), section 196 limits the deduction to 50 percent of such unused credits.[506]

Description of Proposal

This proposal repeals the deduction for certain unused business credits.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Termination of new markets tax credit

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[507] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-

[504] Sec. 38.

[505] Sec. 39.

[506] Sec. 196(d).

[507] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554.

percent credit for each of the following four years.[508] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[509] The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[510]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.[511] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired at its original issue directly (or through an underwriter) from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[512] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments and the investment must be designated as a qualified equity investment by the CDE. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.[513]

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[514] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-

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[508] Sec. 45D(a)(2).

[509] Sec. 45D(a)(3).

[510] Sec. 45D(g).

[511] Sec. 45D(c).

[512] Sec. 45D(b).

[513] Sec. 45D(d).

[514] Sec. 45D(e).

migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[515] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[516] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income. A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.[517]

The maximum annual amount of qualified equity investments is $3.5 billion for calendar years 2010 through 2019. No amount of unused allocation limitation may be carried to any calendar year after 2024.

Description of Proposal

This proposal provides that the new markets tax credit limitation is zero for calendar year 2018 and thereafter and no amount of unused allocation limitation may be carried to any calendar year after 2022.

Effective Date

The proposal applies to calendar years beginning after December 31, 2017.

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[515] Sec. 45D(e)(2).

[516] Pub. L. No. 103-325.

[517] Sec. 45D(d)(2).

7. Repeal of credit for expenditures to provide access to disabled individuals

Present Law

Section 44 provides a 50-percent credit for eligible access expenditures paid or incurred by an eligible small business for the taxable year. The credit is limited to eligible access expenditures exceeding $250 but not exceeding $10,500. The credit is part of the general business credit.[518]

Eligible access expenditures generally means amounts paid or incurred by an eligible small business to comply with requirements under the Americans with Disabilities Act of 1990.[519] These expenditures[520] include: (1) removal of architectural, communication, physical or transportation barriers which prevent a business from being usable or accessible to individuals with disabilities;[521] (2) provision of qualified interpreters or other effective methods of making aurally-delivered materials available to individuals with hearing impairments; (3) provision of qualified readers, taped texts, or other effective methods of making visually-delivered materials available to individuals with visual impairments; (4) acquisition or modification of equipment or devices for individuals with disabilities; or (5) provision of other similar services, modifications, materials or equipment.

An eligible small business means any person that elects application of section 44 and, during the preceding taxable year, (1) had gross receipts not exceeding $1,000,000 or (2) employed not more than 30 full-time employees.[522]

Description of Proposal

The proposal repeals the credit for eligible access expenditures.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[518] Sec. 38(b)(17).

[519] As in effect on November 5, 1990. Sec. 44(c)(1).

[520] These expenditures must be reasonable and necessary, excluding those unnecessary to accomplish listed purposes, and meet standards set forth by the Secretary and the Architectural and Transportation Barriers Compliance Board. Sec. 44(c)(3) and (5).

[521] Expenses related to this removal are not eligible in connection with facilities placed in service after November 5, 1990. Sec. 44(c)(4).

[522] For this definition, an employee is considered full-time if employed at least 30 hours per week for 20 or more calendar weeks in the taxable year.

8. Modification of credit for portion of employer social security taxes paid with respect to employee tips

Present Law

Credit

Certain food or beverage establishments may elect to claim a business tax credit equal to an employer's taxes under the Federal Insurance Contributions Act ("FICA")[523] paid on tips in excess of those treated as wages for purposes of meeting the minimum wage requirements of the Fair Labor Standards Act (the "FLSA") as in effect on January 1, 2007.[524] The credit applies only with respect to FICA taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary. The credit is available whether or not the tips are reported or a percentage of gross receipts is allocated (described below). No deduction is allowed for any amount taken into account in determining the tip credit. A taxpayer may elect not to have the credit apply for a taxable year.

Reporting and allocation requirements

Employees are required to report monthly tips to their employer.[525] Certain large[526] food or beverage establishments are required to report to the IRS and employees various information including gross receipts of the establishment, and to allocate among employees who customarily receive tip income an amount equal to eight percent of gross receipts in excess of the amount of tips reported by such employees.[527] Employee tip income that is reported by employees is treated as employer-provided wages subject to FICA.

Description of Proposal

The proposal revises the amount of the credit for FICA taxes an employer pays on tips, as an amount equal to the employer's FICA taxes paid on tips in excess of those treated as minimum wages under the FLSA without regard to the January 1, 2007 date. For 2017, this amount is $7.25. In addition, the credit is permitted only if the employer satisfies the reporting

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[523] FICA taxes consist of social security (OASDI, or old age, survivor, and disability insurance) and hospital (Medicare) taxes imposed on employers and employees with respect to wages paid to employees under sections 3101-3128.

[524] Sec. 45B. As of January 1, 2007, the Federal minimum wage under the FLSA was $5.15 per hour. In the case of tipped employees, the FLSA provided that the minimum wage could be reduced to $2.13 per hour (that is, the employer is only required to pay cash equal to $2.13 per hour) if the combination of tips and cash income equaled the Federal minimum wage.

[525] Sec. 6053(a).

[526] A large establishment for this purpose is one which normally employed more than 10 employees on a typical business day during the preceding calendar year.

[527] Sec. 6053(c).

requirements of section 6053(c) to the IRS and employees, and allocates among employees who customarily receive tip income an amount equal to 10 percent (rather than eight percent) of gross receipts in excess of the amount of tips reported by such employees. The claiming of the credit remains elective. However, if any size eligible food or beverage establishment elects to claim the FICA tip credit for any taxable year after the proposal takes effect, the establishment must satisfy this reporting and 10 percent allocation requirement for that taxable year. Reporting and allocation requirements for food and beverage establishments that elect not to claim the credit remain unchanged.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

F. Energy Credits

1. Modifications to credit for electricity produced from certain renewable resources

Present Law

In general

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[528] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

Summary of Credit for Electricity Produced from Certain Renewable Resources

Eligible electricity production activity (sec. 45)	Credit amount for 2017 (cents per kilowatt-hour)	Expiration[1]
Wind	2.4	December 31, 2019
Closed-loop biomass	2.4	December 31, 2016
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.2	December 31, 2016
Geothermal	2.4	December 31, 2016
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.2	December 31, 2016
Qualified hydropower	1.2	December 31, 2016
Marine and hydrokinetic	1.2	December 31, 2016

[1] The credit expires for property the construction of which begins after this date.

The credit rate, initially set at 1.5 cents per kilowatt-hour (reduced by one-half for certain renewable resources) is adjusted annually for inflation.[529] In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.

[528] Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[529] The most recent inflation adjustment factors can be in IRS Notice 2017-33, I.R.B. 2017-22, May 30, 2017.

Taxpayers may also elect to get a 30-percent investment tax credit in lieu of this production tax credit.[530]

Phase-down for wind facilities

In the case of wind facilities, the available production tax credit or investment tax credit is reduced by 20 percent for facilities the construction of which begins in 2017, by 40 percent for facilities the construction of which begins in 2018, and by 60 percent for facilities the construction of which begins in 2019.

Description of Proposal

The proposal eliminates the inflation adjustment for wind facilities the construction of which begins after the date of enactment. Such facilities are entitled to a credit of 1.5 cents per kilowatt-hour (*i.e.,* the statutory credit rate unadjusted for inflation). Credits remain subject to the phase-down based on the year construction begins.

The proposal adds a special rule for determining the beginning of construction of a qualified facility. Under the proposal, the construction of any facility, modification, improvement, addition, or other property is not treated as beginning before any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service.

Effective Date

The proposal terminating the inflation adjustment applies to taxable years ending after the date of enactment.

The proposal adding a special rule for determining the beginning of construction of a qualified facility applies to taxable years beginning before, on, or after the date of enactment.

2. Modification of the energy investment tax credit

Present Law

In general

A permanent, nonrefundable, 10-percent business energy credit[531] is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

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[530] Sec. 48(a)(5).

[531] Sec. 48.

In addition to the permanent credit, temporary investment credits are available for a variety of renewable and alternative energy property. The rules governing these temporary credits are described below.

The energy credit is a component of the general business credit.[532] An unused general business credit generally may be carried back one year and carried forward 20 years.[533] The taxpayer's basis in the property is reduced by one-half of the amount of the credit claimed. For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as progress expenditures are made on the project, rather than during the year the property is placed in service. The credit is allowed against the alternative minimum tax.

Solar energy property

The credit rate for solar energy property is increased to 30 percent in the case of property the construction of which begins before January 1, 2020. The rate is increased to 26 percent in the case of property the construction of which begins in calendar year 2020. The rate is increased to 22 percent in the case of property the construction of which begins in calendar year 2021. To qualify for the enhanced credit rates, the property must be placed in service before January 1, 2024.

Additionally, equipment that uses fiber-optic distributed sunlight ("fiber optic solar") to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit, but only for property placed in service before January 1, 2017.

Fuel cell property and microturbine property

The energy credit applies to qualified fuel cell power plant property, but only for periods prior to January 1, 2017. The credit rate is 30 percent.

A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half kilowatt. The credit may not exceed $1,500 for each 0.5 kilowatt of capacity.

The energy credit applies to qualifying stationary microturbine power plant property for periods prior to January 1, 2017. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure

[532] Sec. 38(b)(1).

[533] Sec. 39.

for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency, and power factors. Such system must have an electricity-only generation efficiency of not less than 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

Geothermal heat pump property

The energy credit applies to qualified geothermal heat pump property placed in service prior to January 1, 2017. The credit rate is 10 percent. Qualified geothermal heat pump property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

Small wind property

The energy credit applies to qualified small wind energy property placed in service prior to January 1, 2017. The credit rate is 30 percent. Qualified small wind energy property is property that uses a qualified wind turbine to generate electricity. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less.

Combined heat and power property

The energy credit applies to combined heat and power ("CHP") property placed in service prior to January 1, 2017. The credit rate is 10 percent.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of not more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, systems whose fuel source is at least 90 percent open-loop biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a

credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a 5-percent credit).

Election of energy credit in lieu of section 45 production tax credit

A taxpayer may make an irrevocable election to have the property used in certain qualified renewable power facilities be treated as energy property eligible for a 30-percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production tax credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the production credit under section 45. The 30-percent credit rate phases down in calendar years 2017, 2018, and 2019.

Description of Proposal

The proposal extends the energy credit for fiber optic solar, fuel cell, microturbine, geothermal heat pump, small wind, and combined heat and power property. In each case, the credit is extended for property the construction of which begins before January 1, 2022. In the case of fiber optic solar, fuel cell, and small wind property, the credit rate is reduced to 26 percent for property the construction of which begins in calendar year 2020 and to 22 percent for property the construction of which begins in calendar year 2021. Qualified property must be placed in service before January 1, 2024.

The proposal terminates the permanent credits for solar and geothermal property the construction of which begins after December 31, 2027.

The proposal adds a special rule for determining the beginning of construction of qualified property. Under the proposal, the construction of any facility, modification, improvement, addition, or other property is not treated as beginning before any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service.

Effective Date

The proposal generally applies to periods after December 31, 2016, under rules similar to the rules of section 48(m), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. The extension of the credit for combined heat and power system property applies to property placed in service after December 31, 2016. The reduced credit rates and the termination of the permanent credits are effective on the date of the enactment of the proposal. The special rule for determining the beginning of construction of qualified property applies to taxable years beginning before, on, or after the date of enactment of the proposal.

3. Extension and phaseout of residential energy efficient property

Present Law

In general

Section 25D provides a personal tax credit for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures.

Section 25D also provides a 30 percent credit for the purchase of qualified geothermal heat pump property, qualified small wind energy property, and qualified fuel cell power plants. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

The credit is nonrefundable. The credit with respect to all qualifying property may be claimed against the alternative minimum tax.

With the exception of solar property, the credit expires for property placed in service after December 31, 2016. In the case of qualified solar electric property and solar water heating property, the credit expires for property placed in service after December 31, 2021. In addition, the credit rate for such solar property is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021.

Qualified property

Qualified solar electric property is property that uses solar energy to generate electricity for use in a dwelling unit. Qualifying solar water heating property is property used to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun.

A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, (2) has an electricity-only generation efficiency of greater than 30 percent, and (3) has a nameplate capacity of at least 0.5 kilowatt. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

Qualified small wind energy property is property that uses a wind turbine to generate electricity for use in a dwelling unit located in the United States and used as a residence by the taxpayer.

Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made, and (3) is installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.

Additional rules

The depreciable basis of the property is reduced by the amount of the credit. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

Description of Proposal

The proposal extends the residential energy efficient property credit with respect to non-solar qualified property through December 31, 2021. The credit rate for such property is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021.

Effective Date

The proposal applies to property placed in service after December 31, 2016.

4. Repeal of enhanced oil recovery credit

Present Law

Section 43 provides a 15-percent credit for expenses associated with an enhanced oil recovery ("EOR") project. Qualified EOR costs consist of the following designated expenses associated with an EOR project: (1) amounts paid for depreciable tangible property; (2) intangible drilling and development expenses; (3) tertiary injectant expenses; and (4) construction costs for certain Alaskan natural gas treatment facilities. An EOR project is generally a project that involves increasing the amount of recoverable domestic crude oil through the use of one or more tertiary recovery methods (as defined in section 193(b)(3)), such as injecting steam or carbon dioxide into a well to effect oil displacement. The credit is reduced as the price of oil exceeds a certain threshold.

Description of Proposal

The proposal repeals the enhanced oil recovery credit.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

5. Repeal of credit for producing oil and gas from marginal wells

Present Law

Section 45I provides a \$3-per-barrel credit for the production of crude oil and a \$0.50 credit per 1,000 cubic feet of qualified natural gas production. In both cases, the credit is available only for production from a "qualified marginal well."

A qualified marginal well is defined as a domestic well: (1) production from which is treated as marginal production for purposes of the Code's percentage depletion rules; or (2) that during the taxable year had average daily production of not more than 25 barrel equivalents and produces water at a rate of not less than 95 percent of total well effluent. The maximum amount of production on which credit could be claimed is 1,095 barrels or barrel equivalents.

The credit is not available to production occurring if the reference price of oil exceeds \$18 (\$2.00 for natural gas). The credit is reduced proportionately for reference prices between \$15 and \$18 (\$1.67 and \$2.00 for natural gas).

The credit is treated as a general business credit. Unused credits can be carried back for up to five years rather than the generally applicable carryback period of one year. The credit is indexed for inflation.

Description of Proposal

The proposal repeals the credit for producing oil and gas from marginal wells.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Modifications of credit for production from advanced nuclear power facilities

Present Law

Taxpayers producing electricity at a qualifying advanced nuclear power facility may claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service.[534] The aggregate amount of credit that a taxpayer may claim in any year during the eight-year period is subject to limitation based on allocated capacity and an annual limitation as described below.

An advanced nuclear facility is any nuclear facility for the production of electricity, the reactor design for which was approved after 1993 by the Nuclear Regulatory Commission. For

[534] Sec. 45J. The 1.8-cents credit amount is reduced, but not below zero, if the annual average contract price per kilowatt-hour of electricity generated from advanced nuclear power facilities in the preceding year exceeds eight cents per kilowatt-hour. The eight-cent price comparison level is indexed for inflation after 1992 (12.6 cents for 2017).

this purpose, a qualifying advanced nuclear facility does not include any facility for which a substantially similar design for a facility of comparable capacity was approved before 1994.

A qualifying advanced nuclear facility is an advanced nuclear facility for which the taxpayer has received an allocation of megawatt capacity from the Secretary of the Treasury ("the Secretary") and is placed in service before January 1, 2021. The taxpayer may only claim credit for production of electricity equal to the ratio of the allocated capacity that the taxpayer receives from the Secretary to the rated nameplate capacity of the taxpayer's facility. For example, if the taxpayer receives an allocation of 750 megawatts of capacity from the Secretary and the taxpayer's facility has a rated nameplate capacity of 1,000 megawatts, then the taxpayer may claim three-quarters of the otherwise allowable credit, or 1.35 cents per kilowatt-hour, for each kilowatt-hour of electricity produced at the facility (subject to the annual limitation described below). The credit is restricted to 6,000 megawatts of national capacity. Once that limitation has been reached, the Secretary may make no additional allocations. Treasury guidance required allocation applications to be filed before February 1, 2014.[535]

A taxpayer operating a qualified facility may claim no more than $125 million in tax credits per 1,000 megawatts of allocated capacity in any one year of the eight-year credit period. If the taxpayer operates a 1,350 megawatt rated nameplate capacity system and has received an allocation from the Secretary for 1,350 megawatts of capacity eligible for the credit, the taxpayer's annual limitation on credits that may be claimed is equal to 1.35 times $125 million, or $168.75 million. If the taxpayer operates a facility with a nameplate rated capacity of 1,350 megawatts, but has received an allocation from the Secretary for 750 megawatts of credit eligible capacity, then the two limitations apply such that the taxpayer may claim a credit effectively equal to one cent per kilowatt-hour of electricity produced (calculated as described above) subject to an annual credit limitation of $93.75 million in credits (three-quarters of $125 million).

The credit is part of the general business credit.

Description of Proposal

The proposal modifies the national megawatt capacity limitation for the advanced nuclear power production credit. To the extent any amount of the 6,000 megawatts of authorized capacity remains unutilized, the proposal requires the Secretary to allocate such capacity first to facilities placed in service before the year 2021, to the extent such facilities did not receive an allocation equal to their full nameplate capacity, and then to facilities placed in service after such date in the order in which such facilities are placed in service. The proposal provides that the present-law placed-in-service sunset date of January 1, 2021, does not apply with respect to allocations of such unutilized national megawatt capacity.

The proposal also allows qualified public entities to elect to forgo credits to which they otherwise would be entitled in favor of an eligible project partner. Qualified public entities are defined as (1) a Federal, State, or local government of any political subdivision, agency, or

535 I.R.S. Notice 2013-68, 2013-46 I.R.B. 501.

instrumentality thereof; (2) a mutual or cooperative electric company; or (3) a not-for-profit electric utility which has or had received a loan or loan guarantee under the Rural Electrification Act of 1936.[536] An eligible project partner under the proposal generally includes any person who designed or constructed the nuclear power plant, participates in the provision of nuclear steam or nuclear fuel to the power plant, or has an ownership interest in the facility. In the case of a facility owned by a partnership, where the credit is determined at the partnership level, any electing qualified public entity is treated as the taxpayer with respect to such entity's distributive share of such credits, and any other partner is an eligible project partner.

Effective Date

The proposal requiring the allocation of unutilized national megawatt capacity limitation is effective on the date of enactment. The proposal allowing an election by qualified public entities to forgo credits in favor of an eligible project partner applies to taxable years beginning after the date of enactment.

[536] 7 U.S.C. sec. 901 *et seq.*

G. Bond Reforms

1. Termination of private activity bonds

Present Law

In general

Under present law, gross income generally does not include interest paid on State or local bonds.[537] State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or that are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for State and local bonds only applies to private activity bonds if the bonds are issued for certain permitted purposes ("qualified private activity bonds").

Private activity bonds

Present law provides three main tests for determining whether a State or local bond is in substance a private activity bond, the two-part private business test, the five-percent unrelated or disproportionate use test, and the private loan test.

Private business test

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied–

1. More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and

2. More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe

[537] Sec. 103.

harbors regarding the types of payments made to the private operator and the length of the contract.

Five-percent unrelated or disproportionate business use test

A second standard to determine whether a bond is to be treated as a private activity bond is the five percent unrelated or disproportionate business use test. Under this test the private business use and private payment test (described above) are separately applied substituting five percent for 10 percent and generally only taking into account private business use and private payments that are not related or not proportionate to the government use of the bond proceeds. For example, while a bond issue that finances a new State or local government office building may include a cafeteria, the issue may become a private activity bond if the size of the cafeteria is excessive (as determined under this rule).

Private loan test

The third standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (*e.g.*, personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a private loan.

Special limit on certain output facilities

A special rule for output facilities treats bonds as private activity bonds if more than $15 million of the proceeds of the bond issue are used to finance an output facility (an output facility includes electric and gas generation, transmission and related facilities but not a facility for the furnishing of water).[538]

Special volume cap requirement for larger transactions

A special volume cap requirement for larger transactions treats bonds as private activity bonds if the nonqualified amount of private business use or private payments exceeds $15 million (even if that amount is within the general 10-percent private business limitation for governmental bonds) unless the issuer obtains a private activity bond volume allocation.[539]

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[538] Sec. 141(b)(4).

[539] Sec. 141(b)(5).

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.[540] The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.[541]

In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For 2017, the State volume limit is the greater of $100 multiplied by the State population, or $305.32 million.[542]

Description of Proposal

The proposal repeals the exception from the exclusion from gross income for interest paid on qualified private activity bonds issued after December 31, 2017. Thus, interest on any private activity bond is includible in the gross income of the taxpayer.[543]

Effective Date

The proposal applies to bonds issued after December 31, 2017.

2. Repeal of advance refunding bonds

Present Law

Section 103 generally provides that gross income does not include interest received on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private

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[540] Sec. 141(e).

[541] Sec. 142(a).

[542] Sec. 3.20 of Rev. Proc. 2016-55, 2016-2 C.B. 707.

[543] The bill also terminates section 25 of the Code as it relates to credits associated with mortgage credit certificates issued after December 31, 2017. See section 1102 of the bill (Repeal of nonrefundable credits).

activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals).[544] Bonds issued to finance the activities of charitable organizations described in section 501(c)(3) ("qualified 501(c)(3) bonds") are one type of private activity bond. The exclusion from income for interest on State and local bonds only applies if certain Code requirements are met.

The exclusion for income for interest on State and local bonds applies to refunding bonds but there are limits on advance refunding bonds. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). Different rules apply to current as opposed to advance refunding bonds. A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. Conversely, a bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond.[545] Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed.

Although there is no statutory limitation on the number of times that tax-exempt bonds may be currently refunded, the Code limits advance refundings. Generally, governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time.[546] Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.[547] Furthermore, in the case of an advance refunding bond that results in interest savings (*e.g.*, a high interest rate to low interest rate refunding), the refunded bond must be redeemed on the first call date 90 days after the issuance of the refunding bond that results in debt service savings.[548]

Description of Proposal

The proposal repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.

Effective Date

The proposal applies to advance refunding bonds issued after December 31, 2017.

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[544] Sec. 141.

[545] Sec. 149(d)(5).

[546] Sec. 149(d)(3). Bonds issued before 1986 and pursuant to certain transition rules contained in the Tax Reform Act of 1986 may be advance refunded more than one time in certain cases.

[547] Sec. 149(d)(2).

[548] Sec. 149(d)(3)(A)(iii) and (B); Treas. Reg. sec. 1.149(d)-1(f)(3). A "call" provision provides the issuer of a bond with the right to redeem the bond prior to the stated maturity.

3. Repeal of tax credit bonds

Present Law

In general

Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. Current tax-credit bonds include qualified tax credit bonds, which have certain common general requirements, and include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds.[549]

Qualified tax-credit bonds

General rules applicable to qualified tax-credit bonds[550]

Unlike tax-exempt bonds, qualified tax-credit bonds generally are not interest-bearing obligations. Rather, the taxpayer holding a qualified tax-credit bond on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit rate for an issue of qualified tax credit bonds is determined by the Secretary and is estimated to be a rate that permits issuance of the qualified tax-credit bonds without discount and interest cost to the qualified issuer.[551] The credit accrues quarterly and is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

New clean renewable energy bonds

New clean renewable energy bonds ("New CREBs") may be issued by qualified issuers to finance qualified renewable energy facilities.[552] Qualified renewable energy facilities are facilities that: (1) qualify for the tax credit under section 45 (other than Indian coal and refined coal production facilities), without regard to the placed-in-service date requirements of that

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[549] The authority to issue two other types of tax-credit bonds, recovery zone economic development bonds and Build America Bonds, expired on January 1, 2011.

[550] Certain other rules apply to qualified tax credit bonds, such as maturity limitations, reporting requirements, spending rules, and rules relating to arbitrage. Separate rules apply in the case of tax-credit bonds which are not qualified tax-credit bonds (*i.e.*, "recovery zone economic development bonds," and "Build America Bonds").

[551] However, for new clean renewable energy bonds and qualified energy conservation bonds, the applicable credit rate is 70 percent of the otherwise applicable rate.

[552] Sec. 54C.

section; and (2) are owned by a public power provider, governmental body, or cooperative electric company.

The term "qualified issuers" includes: (1) public power providers; (2) a governmental body; (3) cooperative electric companies; (4) a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act; and (5) clean renewable energy bond lenders. There was originally a national limitation for New CREBs of $800 million. The national limitation was then increased by an additional $1.6 billion in 2009. As with other tax credit bonds, a taxpayer holding New CREBs on a credit allowance date is entitled to a tax credit. However, the credit rate on New CREBs is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer.[553]

Qualified energy conservation bonds

Qualified energy conservation bonds may be used to finance qualified conservation purposes.

The term "qualified conservation purpose" means:

1. Capital expenditures incurred for purposes of: (a) reducing energy consumption in publicly owned buildings by at least 20 percent; (b) implementing green community programs;[554] (c) rural development involving the production of electricity from renewable energy resources; or (d) any facility eligible for the production tax credit under section 45 (other than Indian coal and refined coal production facilities);

2. Expenditures with respect to facilities or grants that support research in: (a) development of cellulosic ethanol or other nonfossil fuels; (b) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels; (c) increasing the efficiency of existing technologies for producing nonfossil fuels; (d) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation; and (e) technologies to reduce energy use in buildings;

3. Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting;

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553 Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

554 Capital expenditures to implement green community programs include grants, loans, and other repayment mechanisms to implement such programs. For example, States may issue these tax credit bonds to finance retrofits of existing private buildings through loans and/or grants to individual homeowners or businesses, or through other repayment mechanisms. Other repayment mechanisms can include periodic fees assessed on a government bill or utility bill that approximates the energy savings of energy efficiency or conservation retrofits. Retrofits can include heating, cooling, lighting, water-saving, storm water-reducing, or other efficiency measures.

4. Demonstration projects designed to promote the commercialization of: (a) green building technology; (b) conversion of agricultural waste for use in the production of fuel or otherwise; (c) advanced battery manufacturing technologies; (d) technologies to reduce peak-use of electricity; and (e) technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; and

5. Public education campaigns to promote energy efficiency (other than movies, concerts, and other events held primarily for entertainment purposes).

There was originally a national limitation on qualified energy conservation bonds of $800 million. The national limitation was then increased by an additional $2.4 billion in 2009. As with other qualified tax credit bonds, the taxpayer holding qualified energy conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer.[555]

Qualified zone academy bonds

Qualifies zone academy bonds ("QZABs") are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy," and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A total of $400 million of QZABs has been authorized to be issued annually in calendar years 1998 through 2008. The authorization was increased to $1.4 billion for calendar year 2009, and also for calendar year 2010. For each of the calendar years 2011 through 2016, the authorization was set at $400 million.

Qualified school construction bonds

Qualified school construction bonds must meet three requirements: (1) 100 percent of the available project proceeds of the bond issue is used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed; (2) the bonds are issued by a State or local government within which such school is located; and (3) the issuer designates such bonds as a qualified school construction bond.

There is a national limitation on qualified school construction bonds of $11 billion for calendar years 2009 and 2010, and zero after 2010. If an amount allocated is unused for a calendar year, it may be carried forward to the following and subsequent calendar years. Under a

[555] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

separate special rule, the Secretary of the Interior may allocate $200 million of school construction bond authority for Indian schools.

Direct-pay bonds and expired tax-credit bond provisions

The Code provides that an issuer may elect to issue certain tax credit bonds as "direct-pay bonds." Instead of a credit to the holder, with a "direct-pay bond" the Federal government pays the issuer a percentage of the interest on the bonds. The following tax credit bonds may be issued as direct-pay bonds: new clean renewable energy bonds, qualified energy conservation bonds, and qualified school construction bonds. Qualified zone academy bonds may not be issued as direct-pay using any national zone academy bond allocation for calendar years after 2011 or any carryforward of such allocations. The ability to issue Build America Bonds and Recovery Zone bonds, which have direct-pay features, has expired.

Description of Proposal

The proposal prospectively repeals authority to issue tax-credit bonds and direct-pay bonds.

Effective Date

The proposal applies to bonds issued after December 31, 2017.

4. No tax-exempt bonds for professional stadiums

Present Law

In general

Section 103 generally provides gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain purposes ("qualified private activity bonds") permitted by the Code and other Code requirements are met.

Private activity bond tests

In general

A private activity bond includes any bond that satisfies (1) the "private business test" (consisting of two components: a private business use test and a private security or payment test); or (2) "the private loan financing test."[556]

Two-part private business test

Under the private business test, a bond is a private activity bond if it is part of an issue in which:

(1) More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit ("private business use test"); and

(2) More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").[557]

A bond is not a private activity bond unless both parts of the private business test (i.e., the private business use test *and* the private payment test) are met. For purposes of the private payment test, both direct and indirect payments made by any private person treated as using the financed property are taken into account. Payments by a person for the use of proceeds generally do not include payments for ordinary and necessary expenses (within the meaning of section 162) attributable to the operation and maintenance of financed property.[558]

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons.

Types of qualified private activity bonds

The interest of qualified private activity bonds is tax exempt. A qualified private activity bond is a qualified mortgage, veterans' mortgage, small issue, student loan, redevelopment, 501(c)(3), or exempt facility bond.[559] To qualify as an exempt facility bond, 95 percent of the

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[556] Sec. 141.

[557] The 10-percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

[558] Treas. Reg. sec. 1.141-4(c)(3).

[559] Sec. 141(e).

net proceeds must be used to finance: (1) airports; (2) docks and wharves; (3) mass commuting facilities; (4) high-speed intercity rail facilities; (5) facilities for the furnishing of water; (6) sewage facilities; (7) solid waste disposal facilities; (8) hazardous waste disposal facilities; (9) qualified residential rental projects; (10) facilities for the local furnishing of electric energy or gas; (11) local district heating or cooling facilities; (12) environmental enhancements of hydroelectric generating facilities; (13) qualified public educational facilities; or (14) qualified green building and sustainable design projects.

Financing of sports facilities with governmental bonds

In 1986, Congress eliminated a provision expressly allowing tax-exempt financing for sports facilities.[560] Nevertheless, professional sports facilities continue to be financed with tax-exempt bonds despite the fact that privately owned sports teams are the primary (if not exclusive) users of such facilities. Present law permits the use of tax-exempt bond proceeds for private activities if either part of the two-part private business test is not met. Only if both parts of the private business test (private use and private payment) are met will the interest on such bonds be taxable. In the case of bond-financed professional sports facilities, issuers have intentionally structured the tax-exempt bond issuance and related transactions to fail the private payment test. In most of these transactions, the professional sports team is not required to pay for more than a small portion of its use of the sports facility. As a result, the private payment test is not met and the bonds financing the facility are not treated as private activity bonds, despite the existence of substantial private business use.

Description of Proposal

The proposal provides that the interest on bonds, the proceeds of which are to be used to finance or refinance capital expenditures allocable to a professional sports stadium, is not tax-exempt. The term "professional sports stadium" means any facility (or appurtenant real property) which during at least five days during any calendar year is used as a stadium or arena for professional sports, exhibitions, games, or training.

Effective Date

The proposal applies to bonds issued after November 2, 2017.

[560] Sec. 1301 of the Tax Reform Act of 1986 (Pub. L. 99-514, 1986) (prior to amendment, sec. 103(b)(4)(B) of the Internal Revenue Code of 1954 permitted tax-exempt financing for sports facilities).

H. Insurance

1. Net operating losses of life insurance companies

Present Law

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[561]

For purposes of computing the alternative minimum tax ("AMT"), a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.[562]

In the case of a life insurance company, a deduction is allowed in the taxable year for operations loss carryovers and carrybacks, in lieu of the deduction for net operation losses allowed to other corporations.[563] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[564]

Description of Proposal

The proposal repeals the operations loss deduction for life insurance companies and allows the NOL deduction under section 172. This provides the same treatment for losses of life insurance companies as for losses of property and casualty insurance companies and of other corporations. The proposal thus limits the companies' NOL deduction to 90 percent of taxable income (determined without regard to the deduction), provides that carryovers to other years are adjusted to take account of this limitation and may be carried forward indefinitely with an inflation adjustment, and repeals the present-law three-year carryback. The NOL deduction of a life insurance company is determined by treating the NOL for any taxable year generally as the excess of the life insurance deductions for such taxable year over the life insurance gross income for such taxable year.

Effective Date

The proposal applies to losses arising in taxable years beginning after December 31, 2017.

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561 Sec. 172(b)(2).

562 Sec. 56(d).

563 Secs. 810, 805(a)(5).

564 Sec. 810(b)(1).

2. Repeal of small life insurance company deduction

Present Law

The small life insurance company deduction for any taxable year is 60 percent of so much of the tentative life insurance company taxable income ("LICTI") for such taxable year as does not exceed $3 million, reduced by 15 percent of the excess of tentative LICTI over $3 million. The maximum deduction that can be claimed by a small company is $1.8 million, and a company with a tentative LICTI of $15 million or more is not entitled to any small company deduction. A small life insurance company for this purpose is one with less than $500 million of assets.

Description of Proposal

The proposal repeals the small life insurance company deduction.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Computation of life insurance tax reserves

Present Law

Reserves

In determining life insurance company taxable income, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[565] Methods for determining reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

In computing the net increase or net decrease in reserves, six items are taken into account. These are (1) life insurance reserves; (2) unearned premiums and unpaid losses included in total reserves; (3) amounts that are discounted at interest to satisfy obligations under insurance and annuity contracts that do not involve life, accident, or health contingencies when the computation is made; (4) dividend accumulations and other amounts held at interest in connection with insurance and annuity contracts; (5) premiums received in advance and liabilities for premium deposit funds; and (6) reasonable special contingency reserves under contracts of group term life insurance or group accident and health insurance that are held for retired lives, premium stabilization, or a combination of both.

Life insurance reserves for any contract are the greater of the net surrender value of the contract or the reserves determined under Federally prescribed rules, but may not exceed the statutory reserve with respect to the contract (for regulatory reporting). In computing the

[565] Sec. 807.

Federally prescribed reserve for any type of contract, the taxpayer must use the tax reserve method applicable to the contract, an interest rate for discounting of reserves to take account of the time value of money, and the prevailing commissioners' standard tables for mortality or morbidity.

Interest rate

The assumed interest rate to be used in computing the Federally prescribed reserve is the greater of the applicable Federal interest rate or the prevailing State assumed interest rate. The applicable Federal interest rate is the annual rate determined by the Secretary under the discounting rules for property and casualty reserves for the calendar year in which the contract is issued. The prevailing State assumed interest rate is generally the highest assumed interest rate permitted to be used in at least 26 States in computing life insurance reserves for insurance or annuity contracts of that type as of the beginning the calendar year in which the contract is issued. In determining the highest assumed rates permitted in at least 26 States, each State is treated as permitting the use of every rate below its highest rate.

A one-time election is permitted (revocable only with the consent of the Secretary) to apply an updated applicable Federal interest rate every five years in calculating life insurance reserves. The election is provided to take account of the fluctuations in market rates of return that companies experience with respect to life insurance contracts of long duration. The use of the updated applicable Federal interest rate under the election does not cause the recalculation of life insurance reserves for any prior year. Under the election no change is made to the interest rate used in determining life insurance reserves if the updated applicable Federal interest rate is less than one-half of one percentage point different from the rate used by the company in calculating life insurance reserves during the preceding five years.

Description of Proposal

The deductible (or includable) amount of life insurance reserves for any taxable year is an amount determined as a percentage of the increase (or decrease) in the annual statement reserve for future unaccrued claims. The applicable percentage is 76.5. The tax reserve is determined without regard to whether the annual statement reserve is determined by formulaic or stochastic methodology.

Reserves for future unaccrued claims are defined to include life insurance reserves (for purposes of the definition of a life insurance company) determined in accordance with the method prescribed by the National Association of Insurance Commissioners and reported by the taxpayer on its annual statement for the calendar year that is the taxable year. The term is defined also to include unpaid losses (in the amount of the discounted unpaid losses defined in section 846) that are included in total reserves. The term is defined also to include amounts (not included as life insurance reserves or unpaid losses) of reserves solely for claims with respect to insurance risks that are determined in accordance with the method prescribed by the National Association of Insurance Commissioners and reported by the taxpayer on its annual statement for the calendar year that is the taxable year. The term is defined to exclude asset adequacy reserves, contingency reserves, unearned premium reserves of a life insurance company, and as provided in guidance promulgated by the Secretary, any other amount not constituting reserves

for future unaccrued claims. The Secretary is to require reporting with respect to the opening and closing balances of reserves and the method of computing reserves for purposes of determining income.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017. For the first taxable year beginning after December 31, 2017, the difference in the amount of the reserve with respect to any contract at the end of the preceding taxable year and the amount of such reserve determined as if the proposal had applied for that year is taken into account for each of the eight taxable years following that preceding year, one-eighth per year.

4. Adjustment for change in computing reserves

Present Law

Change in method of accounting

In general, a taxpayer may change its method of accounting under section 446 with the consent of the Secretary (or may be required to change its method of accounting by the Secretary). In such instances, a taxpayer generally is required to make an adjustment (a "section 481(a) adjustment") to prevent amounts from being duplicated in, or omitted from, the calculation of the taxpayer's income. Pursuant to IRS procedures, negative section 481(a) adjustments generally are deducted from income in the year of the change whereas positive section 481(a) adjustments generally are required to be included in income ratably over four taxable years.[566]

However, section 807(f) explicitly provides that changes in the basis for determining life insurance company reserves are to be taken into account ratably over 10 years.

10-year spread for change in computing life insurance company reserves

For Federal income tax purposes, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[567] Methods for determining reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

Income or loss resulting from a change in the method of computing reserves is taken into account ratably over a 10-year period.[568] The rule for a change in basis in computing reserves applies only if there is a change in basis in computing the Federally prescribed reserve (as distinguished from the net surrender value). Although life insurance tax reserves require the use of a Federally prescribed method, interest rate, and mortality or morbidity table, changes in other

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[566] See, *e.g.*, Rev. Proc. 2015-13, 2015-5 I.R.B. 419, and Rev. Proc. 2017-30, 2017-18 I.R.B. 1131.

[567] Sec. 807.

[568] Sec. 807(f).

assumptions for computing statutory reserves (*e.g.*, when premiums are collected and claims are paid) may cause increases or decreases in a company's life insurance reserves that must be spread over a 10-year period. Changes in the net surrender value of a contract are not subject to the 10-year spread because, apart from its use as a minimum in determining the amount of life insurance tax reserves, the net surrender value is not a reserve but a current liability.

If for any taxable year the taxpayer is not a life insurance company, the balance of any adjustments to reserves is taken into account for the preceding taxable year.

Description of Proposal

Income or loss resulting from a change in method of computing life insurance company reserves is taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

5. Modification of rules for life insurance proration for purposes of determining the dividends received deduction

Present Law

Reduction of reserve deduction and dividends received deduction to reflect untaxed income

A life insurance company is subject to proration rules in calculating life insurance company taxable income.

The proration rules reduce the company's deductions, including reserve deductions and dividends received deductions, if the life insurance company has tax-exempt income, deductible dividends received, or other similar untaxed income items, because deductible reserve increases can be viewed as being funded proportionately out of taxable and tax-exempt income.

Under the proration rules, the net increase and net decrease in reserves are computed by reducing the ending balance of the reserve items by the policyholders' share of tax-exempt interest.[569]

Similarly, under the proration rules, a life insurance company is allowed a dividends-received deduction for intercorporate dividends from nonaffiliates only in proportion to the company's share of such dividends,[570] but not for the policyholders' share. Fully deductible dividends from affiliates are excluded from the application of this proration formula, if such dividends are not themselves distributions from tax-exempt interest or from dividend income that would not be fully deductible if received directly by the taxpayer. In addition, the proration rule

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569 Secs. 807(a)(2)(B) and (b)(1)(B).

570 Secs. 805(a)(4), 812.

includes in prorated amounts the increase for the taxable year in policy cash values of life insurance policies and annuity and endowment contracts.

Company's share and policyholder's share

The life insurance company proration rules provide that the company's share, for this purpose, means the percentage obtained by dividing the company's share of the net investment income for the taxable year by the net investment income for the taxable year.[571] Net investment income means 95 percent of gross investment income, in the case of assets held in segregated asset accounts under variable contracts, and 90 percent of gross investment income in other cases.[572]

Gross investment income includes specified items.[573] The specified items include interest (including tax-exempt interest), dividends, rents, royalties and other related specified items, short-term capital gains, and trade or business income. Gross investment income does not include gain (other than short-term capital gain to the extent it exceeds net long-term capital loss) that is, or is considered as, from the sale or exchange of a capital asset. Gross investment income also does not include the appreciation in the value of assets that is taken into account in computing the company's tax reserve deduction under section 817.

The company's share of net investment income, for purposes of this calculation, is the net investment income for the taxable year, reduced by the sum of (a) the policy interest for the taxable year and (b) a portion of policyholder dividends.[574] Policy interest is defined to include required interest at the greater of the prevailing State assumed rate or the applicable Federal rate (plus some other interest items). Present law provides that in any case where neither the prevailing State assumed interest rate nor the applicable Federal rate is used, "another appropriate rate" is used for this calculation. No statutory definition of "another appropriate rate" is provided; the law is unclear as to what rate or rates are appropriate for this purpose.[575]

[571] Sec. 812(a).

[572] Sec. 812(c).

[573] Sec. 812(d).

[574] Sec. 812(b)(1). This portion is defined as gross investment income's share of policyholder dividends.

[575] Legislative history of section 812 mentions that the general concept that items of investment yield should be allocated between policyholders and the company was retained from prior law. H. Rep. 98-861, Conference Report to accompany H.R. 4170, the Deficit Reduction Act of 1984, 98th Cong., 2d Sess., 1065 (June 23, 1984). *This concept is referred to in* Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, JCS-41-84, December 31, 1984, p. 622, stating, "[u]nder the Act, the formula used for purposes of determining the policyholders' share is based generally on the proration formula used under prior law in computing gain or loss from operations (*i.e.*, by reference to 'required interest')." This may imply that a reference to pre-1984-law regulations may be appropriate. See Rev. Rul. 2003-120, 2003-2 C.B. 1154, and Technical Advice Memoranda 20038008 and 200339049.

In 2007, the IRS issued Rev. Rul. 2007-54,[576] interpreting required interest under section 812(b) to be calculated by multiplying the mean of a contract's beginning-of-year and end-of-year reserves by the greater of the applicable Federal interest rate or the prevailing State assumed interest rate, for purposes of determining separate account reserves for variable contracts. However, Rev. Rul. 2007-54 was suspended by Rev. Rul. 2007-61, in which the IRS and the Treasury Department stated that the issues would more appropriately be addressed by regulation.[577] No regulations have been issued to date.

General account and separate accounts

A variable contract is generally a life insurance (or annuity) contract whose death benefit (or annuity payout) depends explicitly on the investment return and market value of underlying assets.[578] The investment risk is generally that of the policyholder, not the insurer. The assets underlying variable contracts are maintained in separate accounts held by life insurers. These separate accounts are distinct from the insurer's general account in which it maintains assets supporting products other than variable contracts.

Reserves

For Federal income tax purposes, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[579] Methods for determining reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

For purposes of determining the amount of the tax reserves for variable contracts, however, a special rule eliminates gains and losses. Under this rule,[580] in determining reserves for variable contracts, realized and unrealized gains are subtracted, and realized and unrealized losses are added, whether or not the assets have been disposed of. The basis of assets in the separate account is increased to reflect appreciation, and reduced to reflect depreciation in value, that are taken into account in computing reserves for such contracts.

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[576] 2007-38 I.R.B. 604.

[577] 2007-42 I.R.B. 799.

[578] Section 817(d) provides a more detailed definition of a variable contract.

[579] Sec. 807.

[580] Sec. 817.

Dividends received deduction

A corporate taxpayer may partially or fully deduct dividends received.[581] The percentage of the allowable dividends received deduction depends on the percentage of the stock of the distributing corporation that the recipient corporation owns.

Limitation on dividends received deduction under section 246(c)(4)

The dividends received deduction is not allowed with respect to stock either (1) held for 45 days or less during a 91-day period beginning 45 days before the ex-dividend date, or (2) to the extent the taxpayer is under an obligation to make related payments with respect to positions in substantially similar or related property.[582] The taxpayer's holding period is reduced for periods during which its risk of loss is reduced.[583]

Description of Proposal

The proposal modifies the life insurance company proration rule for reducing dividends received deductions and reserve deductions with respect to untaxed income. For purposes of the life insurance proration rule of section 805(a)(4), the company's share is 40 percent. The policyholder's share is 60 percent.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account

Present and Prior Law

Under the law in effect from 1959 through 1983, a life insurance company was subject to a three-phase taxable income computation under Federal tax law. Under the three-phase system, a company was taxed on the lesser of its gain from operations or its taxable investment income (Phase I) and, if its gain from operations exceeded its taxable investment income, 50 percent of such excess (Phase II). Federal income tax on the other 50 percent of the gain from operations was deferred, and was accounted for as part of a policyholder's surplus account and, subject to certain limitations, taxed only when distributed to stockholders or upon corporate dissolution

[581] Sec. 243 *et seq*. Conceptually, dividends received by a corporation are retained in corporate solution; these amounts are taxed when distributed to noncorporate shareholders.

[582] Sec. 246(c).

[583] Sec. 246(c)(4). For this purpose, the holding period is reduced for periods in which (1) the taxpayer has an obligation to sell or has shorted substantially similar stock; (2) the taxpayer has granted an option to buy substantially similar stock; or (3) under Treasury regulations, the taxpayer has diminished its risk of loss by holding other positions with respect to substantially similar or related property.

(Phase III). To determine whether amounts had been distributed, a company maintained a shareholders surplus account, which generally included the company's previously taxed income that would be available for distribution to shareholders. Distributions to shareholders were treated as being first out of the shareholders surplus account, then out of the policyholders surplus account, and finally out of other accounts.

The Deficit Reduction Act of 1984[584] included provisions that, for 1984 and later years, eliminated further deferral of tax on amounts (described above) that previously would have been deferred under the three-phase system. Although for taxable years after 1983, life insurance companies may not enlarge their policyholders surplus account, the companies are not taxed on previously deferred amounts unless the amounts are treated as distributed to shareholders or subtracted from the policyholders surplus account.[585]

Any direct or indirect distribution to shareholders from an existing policyholders surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Present law (like prior law) provides that any distribution to shareholders is treated as made (1) first out of the shareholders surplus account, to the extent thereof, (2) then out of the policyholders surplus account, to the extent thereof, and (3) finally, out of other accounts.

For taxable years beginning after December 31, 2004, and before January 1, 2007, the application of the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a life insurance company were suspended. Distributions in those years were treated as first made out of the policyholders surplus account, to the extent thereof, and then out of the shareholders surplus account, and lastly out of other accounts.

Description of Proposal

The proposal repeals section 815, the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a stock life insurance company.

In the case of any stock life insurance company with an existing policyholders surplus account (as defined in section 815 before its repeal), tax is imposed on the balance of the account as of December 31, 2017. A life insurance company is required to pay tax on the balance of the account ratably over the first eight taxable years beginning after December 31, 2017. Specifically, the tax imposed on a life insurance company is the tax on the sum of life insurance company taxable income for the taxable year (but not less than zero) plus 1/8 of the balance of the existing policyholders surplus account as of December 31, 2017. Thus, life insurance company losses are not allowed to offset the amount of the policyholders surplus account balance subject to tax.

[584] Pub. L. No. 98-369.

[585] Sec. 815.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

7. Modification of proration rules for property and casualty insurance companies

Present Law

The taxable income of a property and casualty insurance company is determined as the sum of its gross income from underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions.

A proration rule applies to property and casualty insurance companies. In calculating the deductible amount of its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15 percent of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment, or annuity contracts the company owns.[586] This proration rule reflects the fact that reserves are generally funded in part from tax-exempt interest, from deductible dividends, and from other untaxed amounts.

Description of Proposal

The proposal replaces the 15-percent reduction under present law with a 26.25-percent reduction under the proration rule for property and casualty insurance companies. This change in the percentage takes into account the reduction in the corporate tax rate from 35 to 20 percent under section 3001 of the bill (Reduction in corporate tax rate).

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

8. Modification of discounting rules for property and casualty insurance companies

Present Law

A property and casualty insurance company generally is subject to tax on its taxable income.[587] The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions.[588] Among the items that are deductible in calculating underwriting income are additions to reserves for losses incurred and expenses incurred.

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[586] Sec. 832(b)(5).

[587] Sec. 831(a).

[588] Sec. 832.

To take account of the time value of money, discounting of unpaid losses is required. All property and casualty loss reserves (unpaid losses and unpaid loss adjustment expenses) for each line of business (as shown on the annual statement) are required to be discounted for Federal income tax purposes.

The discounted reserves are calculated using a prescribed interest rate which is based on the applicable Federal mid-term rate ("mid-term AFR"). The discount rate is the average of the mid-term AFRs effective at the beginning of each month over the 60-month period preceding the calendar year for which the determination is made.

To determine the period over which the reserves are discounted, a prescribed loss payment pattern applies. The prescribed length of time is either the accident year and the following three calendar years, or the accident year and the following 10 calendar years, depending on the line of business. In the case of certain "long-tail" lines of business, the 10-year period is extended, but not by more than five additional years. Thus, present law limits the maximum duration of any loss payment pattern to the accident year and the following 15 years. The Treasury Department is directed to determine a loss payment pattern for each line of business by reference to the historical loss payment pattern for that line of business using aggregate experience reported on the annual statements of insurance companies, and is required to make this determination every five years, starting with 1987.

Under the discounting rules, an election is provided permitting a taxpayer to use its own (rather than an industry-wide) historical loss payment pattern with respect to all lines of business, provided that applicable requirements are met.

Treasury publishes discount factors for each line of business to be applied by taxpayers for discounting reserves.[589] The discount factors are published annually, based on (1) the interest rate applicable to the calendar year, and (2) the loss payment pattern for each line of business as determined every five years.

Description of Proposal

The proposal modifies the reserve discounting rules applicable to property and casualty insurance companies. In general, the proposal modifies the prescribed interest rate, extends the periods applicable under the loss payment pattern, and repeals the election to use a taxpayer's historical loss payment pattern.

Interest rate

The proposal provides that the interest rate is an annual rate for any calendar year to be determined by Treasury based on the corporate bond yield curve (rather than the mid-term AFR as under present law). For this purpose, the corporate bond yield curve means, with respect to any month, a yield curve that reflects the average, for the preceding 24-month period, of monthly

[589] The most recent property and casualty reserve discount factors published by Treasury are in Rev. Proc. 2016-58, 2016-51 I.R.B. 839, and see Rev. Proc. 2012-44, 2012-49 I.R.B. 645.

yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available.[590] Because the corporate bond yield curve provides for 24-month averaging, the present-law rule providing for 60-month averaging to determine the interest rate is repealed under the proposal. It is expected that Treasury will determine a 24-month average for the 24 months preceding the first month of the calendar year for which the determination is made.

Loss payment patterns

The proposal extends the periods applicable for determining loss payment patterns. Under the proposal, the maximum duration of the loss payment pattern is determined by the amount of losses remaining unpaid using aggregate industry experience for each line of business, rather than by a set number of years as under present law.

Like present law, the proposal provides that Treasury determines a loss payment pattern for each line of business by reference to the historical loss payment pattern for that line of business using aggregate experience reported on the annual statements of insurance companies, and is required to make this determination every five years.

Under the proposal, the present-law three-year and 10-year periods following the accident year are extended up to a maximum of 15 more years for the lines of business to which each period applies. For lines of business to which the three-year period applies, the amount of losses that would have been treated as paid in the third year after the accident year is treated as paid in that year and each subsequent year in an amount equal to the amount treated as paid in the second year (or, if less, the remaining amount). To the extent these unpaid losses have not been treated as paid before the 18th year after the accident year, they are treated as paid in that 18th year.

Similarly, for lines of business to which the 10-year period applies, the amount of losses that would have been treated as paid in the 10th year following the accident year is treated as paid in that year and each subsequent year in an amount equal to the amount treated as paid in the ninth year (or if less, the remaining amount). To the extent these unpaid losses have not been treated as paid before the 25th year after the accident year, they are treated as paid in that 25th year.

The proposal repeals the present-law rule providing that in the case of certain "long-tail" lines of business, the 10-year period is extended, but not by more than five additional years. The proposal does not change the lines of business to which the three-year, and 10-year, periods, respectively, apply.

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590 This rule adopts the definition found in section 430(h)(2)(D)(i) of the term "corporate bond yield curve." Section 430, which relates to minimum funding standards for single-employer defined benefit pension plans, includes other rules for determining an "effective interest rate," such as segment rate rules. The term "effective interest rate" along with these other rules, including the segment rate rules, do not apply for purposes of property and casualty insurance reserve discounting.

Election to use own historical loss payment pattern

The proposal repeals the present-law election permitting a taxpayer to use its own (rather than an aggregate industry-experience-based) historical loss payment pattern with respect to all lines of business.

Effective Date

The proposal generally applies to taxable years beginning after December 31, 2017. Under a transitional rule for the first taxable year beginning in 2018, the amount of unpaid losses and expenses unpaid (under section 832(b)(5)(B) and (6)) and the unpaid losses (under sections 807(c)(2) and 805(a)(1)) at the end of the preceding taxable year are determined as if the proposal had applied to these items in such preceding taxable year, using the interest rate and loss payment patterns for accident years ending with calendar year 2018. Any adjustment is spread over eight taxable years, *i.e.*, is included in the taxpayer's gross income ratably in the first taxable year beginning in 2018 and the seven succeeding taxable years. For taxable years subsequent to the first taxable year beginning in 2018, the proposal applies to such unpaid losses and expenses unpaid (*i.e.*, unpaid losses and expenses unpaid at the end of the taxable year preceding the first taxable year beginning in 2018) by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018.

9. Repeal of special estimated tax payments

Present Law

Allowance of additional deduction and establishment of special loss discount account

Present law allows an insurance company required to discount its reserves an additional deduction that is not to exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year.[591] The provision imposes the requirement that a special loss discount account be established and maintained, and that special estimated tax payments be made. Unused amounts of special estimated tax payments are treated as a section 6655 estimated tax payment for the 16th year after the year for which the special estimated tax payment was made.

The total payments by a taxpayer, including section 6655 estimated tax payments and other tax payments, together with special estimated tax payments made under this provision, are generally the same as the total tax payments that the taxpayer would make if the taxpayer did not elect to have this provision apply, except to the extent amounts can be refunded under the provision in the 16th year.

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[591] Sec. 847.

Calculation of special estimated tax payments based on tax benefit attributable to deduction

More specifically, present law imposes a requirement that the taxpayer make special estimated tax payments in an amount equal to the tax benefit attributable to the additional deduction allowed under the provision. If amounts are included in gross income as a result of a reduction in the taxpayer's special loss discount account or the liquidation or termination of the taxpayer's insurance business, and an additional tax is due for any year as a result of the inclusion, then an amount of the special estimated tax payments equal to such additional tax is applied against such additional tax. If there is an adjustment reducing the amount of additional tax against which the special estimated tax payment was applied, then in lieu of any credit or refund for the reduction, a special estimated tax payment is treated as made in an amount equal to the amount that would otherwise be allowable as a credit or refund.

The amount of the tax benefit attributable to the deduction is to be determined (under Treasury regulations (which have not been promulgated)) by taking into account tax benefits that would arise from the carryback of any net operating loss for the year as well as current year benefits. In addition, tax benefits for the current and carryback years are to take into account the benefit of filing a consolidated return with another insurance company without regard to the consolidation limitations imposed by section 1503(c).

The taxpayer's estimated tax payments under section 6655 are to be determined without regard to the additional deduction allowed under this provision and the special estimated tax payments. Legislative history[592] indicates that it is intended that the taxpayer may apply the amount of an overpayment of any section 6655 estimated tax payments for the taxable year against the amount of the special estimated tax payment required under this provision. The special estimated tax payments under this provision are not treated as estimated tax payments for purposes of section 6655 (*e.g.*, for purposes of calculating penalties or interest on underpayments of estimated tax) when such special estimated tax payments are made.

Refundable amount

To the extent that a special estimated tax payment is not used to offset additional tax due for any of the first 15 taxable years beginning after the year for which the payment was made, such special estimated tax payment is treated as an estimated tax payment made under section 6655 for the 16th year after the year for which the special estimated tax payment was made. If the amount of such deemed section 6655 payment, together with the taxpayer's other payments credited against tax liability for such 16th year, exceeds the tax liability for such year, then the excess (up to the amount of the deemed section 6655 payment) may be refunded to the taxpayer to the same extent provided under present law with respect to overpayments of tax.

[592] See H.R. Rep. No. 100-1104, Conference Report to accompany H.R. 4333, the Technical and Miscellaneous Revenue Act of 1988, October 21, 1988, p. 174.

Regulatory authority

In addition to the regulatory authority to adjust the amount of special estimated tax payments in the event of a change in the corporate tax rate, authority is provided to Treasury to prescribe regulations necessary or appropriate to carry out the purposes of the provision.

Such regulations include those providing for the separate application of the provision with respect to each accident year. Separate application of the provision with respect to each accident year (*i.e.*, applying a vintaging methodology) may be appropriate under regulations to determine the amount of tax liability for any taxable year against which special estimated tax payments are applied, and to determine the amount (if any) of special estimated tax payments remaining after the 15th year which may be available to be refunded to the taxpayer.

Regulatory authority is also provided to make such adjustments in the application of the provision as may be necessary to take into account the corporate alternative minimum tax. Under this regulatory authority, rules similar to those applicable in the case of a change in the corporate tax rate are intended to apply to determine the amount of special estimated tax payments that may be applied against tax calculated at the corporate alternative minimum tax rate. The special estimated tax payments are not treated as payments of regular tax for purposes of determining the taxpayer's alternative minimum tax liability.

Regulations have not been promulgated under section 847.

Description of Proposal

The proposal repeals section 847. Thus, the election to apply section 847, the additional deduction, special loss discount account, special estimated tax payment, and refundable amount rules of present law are eliminated.

The entire balance of an existing account is included in income of the taxpayer for the first taxable year beginning after 2017, and the entire amount of existing special estimated tax payments are applied against the amount of additional tax attributable to this inclusion. Any special estimated tax payments in excess of this amount are treated as estimated tax payments under section 6655.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

10. Capitalization of certain policy acquisition expenses

Present Law

In the case of an insurance company, specified policy acquisition expenses for any taxable year are required to be capitalized, and generally are amortized over the 120-month period beginning with the first month in the second half of the taxable year.[593]

Specified policy acquisition expenses are determined as that portion of the insurance company's general deductions for the taxable year that does not exceed a specific percentage of the net premiums for the taxable year on each of three categories of insurance contracts. For annuity contracts, the percentage is 1.75; for group life insurance contracts, the percentage is 2.05; and for all other specified insurance contracts, the percentage is 7.7.

With certain exceptions, a specified insurance contract is any life insurance, annuity, or noncancellable accident and health insurance contract or combination thereof. A group life insurance contract is any life insurance contract that covers a group of individuals defined by reference to employment relationship, membership in an organization, or similar factor, the premiums for which are determined on a group basis, and the proceeds of which are payable to (or for the benefit of) persons other than the employer of the insured, an organization to which the insured belongs, or other similar person.

Description of Proposal

The three categories of insurance contracts are replaced with two categories: (1) group contracts and (2) all other specified insurance contracts. The percentage of net premiums that may be treated as specified policy acquisition expenses is four percent for group insurance contracts and 11 percent for all other specified insurance contracts.

A group insurance contract is any specified insurance contract that covers a group of individuals defined by reference to employment relationship, membership in an organization, or similar factor, the premiums for which are determined on a group basis, and the proceeds of which are payable to (or for the benefit of) persons other than the employer of the insured, an organization to which the insured belongs, or other similar person.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

[593] Sec. 848.

I. Compensation

1. Nonqualified deferred compensation

Present Law

In general

Compensation may be received currently or may be deferred to a later time. The tax treatment of deferred compensation depends on whether it is qualified (that is, eligible for tax-favored treatment)[594] or nonqualified and, if nonqualified, whether it is funded or unfunded. In the case of a funded nonqualified deferred compensation arrangement, funded amounts are included in income when the right to the compensation vests, that is, when it is no longer subject to a substantial risk of forfeiture.[595] Earnings after vesting may be taxed annually or when paid.

Under general tax principles, unfunded nonqualified deferred compensation generally is not included in income until actually or constructively received.[596] However, under statutory rules generally applicable to nonqualified deferred compensation arrangements, income inclusion is delayed until receipt only if specific requirements are met. Otherwise, deferred amounts are included in income at vesting, with certain additional income taxes. In addition, in the case of certain arrangements, statutory rules require nonqualified deferred compensation to be included in income at vesting, and depending on the arrangement, earnings after vesting may be taxed annually or when paid.

General rules for nonqualified deferred compensation

In general

Various requirements apply to a nonqualified deferred compensation plan in order to avoid income inclusion at vesting.[597] Absent a specific exception, these requirements apply in addition to any special rules for particular types of nonqualified deferred compensation plans.

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[594] For a discussion of present law relating to tax-favored retirement plans, see Joint Committee on Taxation, *Report to the House Committee on Ways and Means on Present Law and Suggestions for Reform Submitted to the Tax Reform Working Groups* (JCS-3-13), May 6, 2013, Part II.I.

[595] Depending on the funding vehicle, the tax treatment of funded nonqualified deferred compensation may be governed by section 83, 402(b), or 403(c). Similar treatment applies under a common law doctrine of economic benefit, as applied, for example, in *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952), and Rev. Rul. 60-31, Situation 4, 1960-1 C.B. 174. Under section 404(a)(5), (b), and (d), nonqualified deferred compensation is generally deductible by the service recipient for the taxable year in which the amount is includible in the service provider's income, subject to any applicable limits on deductibility.

[596] Treas. Reg. secs. 1.451-1(a) and 1.451-2; Rev. Rul. 60-31, 1960-1 C.B. 174.

[597] Section 409A, generally effective for amounts deferred in taxable years beginning after December 31, 2004. For further discussion of the tax treatment of nonqualified deferred compensation before 2005 and concerns

A nonqualified deferred compensation plan must provide that compensation for services performed during a taxable year generally may be deferred at the service provider's election only if the election to defer is made no later than the close of the preceding taxable year (or at such other time as provided in Treasury regulations). In the case of any performance-based compensation for services performed over a period of at least 12 months, the election may be made no later than six months before the end of the service period. The time and form of distributions from the plan must be specified at the time of initial deferral. However, subject to certain requirements, a plan may allow later changes in the time and form of distributions.

Distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary of the Treasury), death, a specified time (or pursuant to a fixed schedule), change in control of a corporation (to the extent provided by the Secretary of the Treasury), occurrence of an unforeseeable emergency, or if the service provider becomes disabled.[598] A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary of the Treasury, may not permit acceleration of a distribution.

If these requirements are not met, all amounts deferred by a service provider under the plan are currently includible in income to the extent such amounts are not subject to a substantial risk of forfeiture and not previously included in gross income.[599] For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any person or the occurrence of a condition related to a purpose of the compensation, provided that the possibility of forfeiture is substantial. A condition imposed on the right to compensation may constitute a substantial risk of forfeiture

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that led to the enactment of section 409A, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS-5-05), May 2005.

[598] Under a special rule, when a "specified employee" separates from service, distributions may not be made earlier than six months after the date of the separation from service or, if earlier, the date of the employee's death. Specified employees are key employees (as defined in section 416(i)) of publicly-traded corporations and generally include officers (limited to 50 employees) having annual compensation greater than $170,000 (for 2014), five-percent owners, and one-percent owners having annual compensation from the employer greater than $150,000.

[599] In the case of an employee, under section 3401(a), the amount included in income constitutes wages subject to income tax withholding. In addition to current income inclusion, interest at the rate applicable to underpayments of tax plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or, if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax. Under section 409A(b), current income inclusion, interest, and a 20-percent additional tax may also result from certain arrangements involving offshore assets set aside to fund nonqualified deferred compensation (regardless of whether the assets are available to satisfy claims of the general creditors of the service recipient), the restriction of assets to provide nonqualified deferred compensation in connection with a change in the employer's financial health, or assets set aside to provide nonqualified deferred compensation during a period when the employer (or controlled group member) maintains an underfunded defined benefit plan.

even if the imposition of the condition was intended in whole or in part to defer taxation of the compensation to the service provider.[600]

Definition of nonqualified deferred compensation plan

A nonqualified deferred compensation plan subject to these rules generally includes any plan, agreement or arrangement (including an agreement or arrangement that includes one person) that provides for the deferral of compensation (including actual or notional income on deferred compensation), other than a qualified employer plan, or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.[601] A qualified employer plan for this purpose means a qualified retirement plan, a tax-deferred annuity plan, a simplified employee pension plan, a simple retirement account plan, an eligible deferred compensation plan of a tax-exempt or State or local government employer, a plan established before June 25, 1959, and funded only by employee contributions, or a qualified governmental excess benefit arrangement.[602]

Under Treasury regulations, certain other types of arrangements are not considered a deferral of compensation and thus are not subject to these rules.[603] For example, an exception applies to amounts that are not deferred beyond a short period of time after the amount is no longer subject to a substantial risk of forfeiture (referred to as a "short-term deferral").[604] Under this exception, a deferral of compensation generally does not occur if the service provider actually or constructively receives the amount on or before the last day of the applicable two and one-half month period. The applicable two and one-half month period is the period ending on the later of the 15th day of the third month following the end of: (1) the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture; or (2) the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture.

In addition, Treasury regulations provide an exception for certain separation pay (severance) arrangements. This exception applies to separation pay pursuant to a window program, or separation pay provided upon an involuntary separation from service (as defined) that meets certain requirements as to amount and timing of payment. The amount cannot exceed twice the service provider's annualized compensation in the preceding taxable year (or if less, twice the section 401(a)(17) limit in effect for the year in which the separation from service occurs); and the plan must require this amount to be paid no later than the end of the second

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600 Sec. 409A(d)(4) and Treas. Reg. sec. 1.409A-1(d). The Secretary of the Treasury is authorized to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 409A.

601 Sec. 409A(d)(1).

602 Secs. 401(a), 403(a) and (b), 408(k) and (p), 457(b), 501(c)(18), and 415(m).

603 For a discussion of intended exceptions for certain arrangements, see Conference Report to accompany H.R. 4520, the American Jobs Creation Act of 2004, H.R. Rep. No. 108-755, October 7, 2004, p. 735.

604 Treas. Reg. sec. 1.409A-1(b)(4).

taxable year following the end of the service provider's taxable year in which the separation from service occurred.[605]

Treasury regulations also provide exceptions for certain stock options and stock appreciation rights ("SARs") with respect to service recipient stock, referred to collectively as "stock rights."[606] In general, under the regulations, a stock option or SAR does not provide for the deferral of compensation if the exercise price of the stock option or SAR cannot be less than the fair market value, on the date the option or SAR is granted, of the stock subject to the option or SAR and the stock right does not otherwise include a deferral feature. Similar exceptions apply to arrangements involving mutual company units and partnership interests. Exceptions apply also for incentive stock options and options under an employee stock purchase plan ("statutory options").[607]

Additional rules

Under Treasury regulations, the term "service provider" includes an individual or any of specified entities for any taxable year for which the individual or entity accounts for income from the performance of services under the cash receipts and disbursements method of accounting.[608] The relevant entities are a corporation, an S corporation, a partnership, a personal service corporation, a noncorporate entity that would be a personal service corporation if it were a corporation, a qualified personal service corporation, and a noncorporate entity that would be a qualified personal service corporation if it were a corporation. However, an exception applies for a service provider engaged in the trade or business of providing services (other than as an employee or director of a corporation or in a similar position in the case of an entity that is not a corporation) if the service provider provides significant services to at least two service recipients that are not related to each other or the service provider. This exception does not apply to the extent the service provider provides management services, that is, services involving the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient, or investment management or advisory services provided to a service recipient whose primary trade or business includes the investment of financial assets (including real estate investments), such as a hedge fund or real estate investment trust.

[605] Treas. Reg. sec. 1.409A-1(b)(9)(iii).

[606] Treas. Reg. sec. 1.409A-1(b)(5). A SAR is a right to compensation based on the appreciation in value of a specified number of shares of stock occurring between the date of grant and the date of exercise of the right. In the case of a SAR, the exercise price is the amount subtracted from the fair market value of the stock on the date the SAR is exercised to determine the appreciation in value since the date of grant.

[607] Secs. 421-424.

[608] Treas. Reg. sec. 1.409A-1(f).

Nonqualified deferred compensation of State or local government or tax-exempt employers

Special rules apply to "eligible[609]" and "ineligible" deferred compensation plans of State and local government and tax-exempt employers.[610]

Amounts deferred under an eligible deferred compensation plan generally are not included in income until received. In order for a plan to be an eligible plan, the plan must limit deferrals to a dollar amount ($18,000 for 2017, plus an additional "catch-up" amount for older participants) or, if less, the participant's includible compensation. The plan must also meet various other requirements.

In the case of an ineligible deferred compensation plan (that is, a plan that does not meet the requirements to be an eligible plan), deferred amounts are treated as nonqualified deferred compensation and includible in income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, even though the plan is unfunded. For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any individual.[611] Earnings post vesting are generally taxed when paid.

Certain plans are excluded from being treated as deferred compensation, including bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefits.[612]

Nonqualified deferred compensation from certain tax indifferent parties

In general

Under special rules, any compensation deferred under a nonqualified deferred compensation plan of a nonqualified entity is generally includible in income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation, regardless of the method of accounting used by the service provider.[613] For this purpose, a service provider's rights to compensation are subject to a substantial risk of forfeiture

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[609] Some aspects of the rules for eligible deferred compensation plans are quite different for plans of State or local government employers and plans of tax-exempt employers. In particular, an eligible deferred compensation plan of a State or local government is a tax-favored, funded arrangement, similar to a qualified defined contribution plan, whereas an eligible deferred compensation plan of a tax-exempt employer must be unfunded. These rules in effect limit the amount of unfunded nonqualified deferred compensation that can be provided on a tax-deferred basis by a tax-exempt employer.

[610] Sec. 457, which also contains exceptions for various arrangements.

[611] Sec. 457(f)(3)(B).

[612] Sec. 457(e)(11)(A).

[613] Section 457A, generally effective for deferred amounts attributable to services performed after December 31, 2008.

only if the rights are conditioned on the future performance of substantial services by any individual.[614] A condition related to a purpose of the compensation (other than future performance of substantial services) does not result in a substantial risk of forfeiture.

If the amount of any deferred compensation is not determinable at the time the compensation is otherwise includible in income, the compensation is includible when the amount becomes determinable. In that case, the income tax attributable to the compensation includible in income is increased by the sum of (1) an interest charge, and (2) an amount equal to 20 percent of the includible compensation. The interest charge is equal to the interest at the rate applicable to underpayments of tax plus one percentage point imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

Nonqualified entity

The term "nonqualified entity" includes certain foreign corporations and certain partnerships (either domestic or foreign). A foreign corporation is a nonqualified entity unless substantially all of its income is effectively connected with the conduct of a U.S. trade or business or is subject to a comprehensive foreign income tax. A partnership is a nonqualified entity unless substantially all of its income is allocated to persons other than foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax and organizations exempt from U.S. income tax.

The term comprehensive foreign income tax means with respect to a foreign person, the income tax of a foreign country if (1) the person is eligible for the benefits of a comprehensive income tax treaty between the foreign country and the United States, or (2) the person demonstrates to the satisfaction of the Secretary of the Treasury that the foreign country has a comprehensive income tax.

Nonqualified deferred compensation

For purposes of these special rules, the term "nonqualified deferred compensation plan" is generally defined in the same manner as under the general rules for nonqualified deferred compensation (and includes any agreement or arrangement, as well as actual or notional income on deferred compensation) with certain modifications.

Nonqualified deferred compensation includes any plan that provides a right to compensation based on the appreciation in value of a specified number of equity units of the

[614] Under section 457A(d)(1)(B), to the extent provided in regulations, if compensation is determined solely by reference to the amount of gain recognized on the disposition of an investment asset, the compensation is treated as subject to a substantial risk of forfeiture until the date of such disposition. No regulations or other guidance applying this rule has been issued.

service recipient.[615] However, IRS guidance provides some exceptions.[616] In general, under the guidance, a stock option is not treated as nonqualified deferred compensation for this purpose if the exercise price of the stock option cannot be less than the fair market value, on the date the option is granted, of the stock subject to the option and the option does not otherwise include a deferral feature. A similar exception applies to arrangements involving the right to purchase an equity interest in a noncorporate entity. Exceptions apply also for statutory options. Finally, an exception applies for a SAR if the exercise price of the SAR cannot be less than the fair market value, on the date the SAR is granted, of the stock subject to the SAR and the SAR does not otherwise include a deferral feature, but only if the SAR by its terms at all times must be settled in service recipient stock and is settled in service recipient stock.

A special "short-term deferral" exception applies, under which compensation is not treated as deferred if the service provider receives payment of the compensation not later than 12 months after the end of the taxable year of the service recipient during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture (within the meaning of the special rules).

Description of Proposal

In general

Under the proposal, any compensation deferred under a nonqualified deferred compensation plan is includible in the gross income of the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation. For this purpose, the rights of a service provider to compensation are treated as subject to a substantial risk of forfeiture only if the rights are conditioned on the future performance of substantial services by any individual. Under the proposal, a condition related to a purpose of the compensation other than the future performance of substantial services (such as a condition based on achieving a specified performance goal or a condition intended in whole or in part to defer taxation) does not create a substantial risk of forfeiture, regardless of whether the possibility of forfeiture is substantial. In addition, a covenant not to compete does not create a substantial risk of forfeiture.

The proposal applies without regard to the method of accounting of the service provider. Because of the definition of substantial risk of forfeiture under the proposal, a taxpayer using either the cash method of accounting or the accrual method of accounting may be required to include deferred compensation in income earlier than the method of accounting would otherwise require.

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[615] Sec. 457A(d)(3)(A). The Secretary of the Treasury is authorized to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 457A.

[616] Notice 2009-8, 2009-1 C.B. 347, A-2(b). For a discussion of intended exceptions for certain arrangements, see Committee on Ways and Means Report to accompany H.R. 6049, the Renewable Energy and Job Creation Act of 2008, H.R. Rep. No. 110-658, May 20, 2008, pp. 195-196.

Nothing under the proposal is to be construed to prevent the inclusion of amounts in income under any other income tax provision or any other rule of law earlier than the time provided in the proposal. Any amount included in income under the proposal is not required to be included in income under any other income tax provision or any other rule of law later than the time provided under the proposal.

Nonqualified deferred compensation

For purposes of the proposal, the term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than a qualified employer plan, a bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plan, and any other plan or arrangement designated by the Secretary of the Treasury consistent with the purposes of the proposal. The Secretary shall not provide an exception for severance plans, bona fide or otherwise, in regulations or other guidance. A qualified employer plan for this purpose means a qualified retirement plan, a tax-deferred annuity plan, a simplified employee pension plan, a simple retirement account plan, an eligible deferred compensation plan of a State or local government employer, or a plan established before June 25, 1959, and funded only by employee contributions.

In addition, a nonqualified deferred compensation plan for purposes of the proposal specifically includes any plan that provides a right to compensation based on the value of, or the appreciation in value of, a specified number of equity units of the service recipient. Such a compensation right does not fail to provide for the deferral of compensation merely because the compensation is to be paid in cash or by the transfer of equity. The proposal applies to all stock options and SARs (and similar arrangements involving noncorporate entities), regardless of how the exercise price compares to the value of the related stock on the date the option or SAR is granted. It is intended that no exceptions are to be provided in regulations or other administrative guidance. However, it is intended that statutory options are not considered nonqualified deferred compensation for purposes of the proposal. An exception is provided for that portion of a plan consisting of a transfer of property described in section 83 (other than stock options) or which consists of a trust to which section 402(b) applies.

For purposes of the proposal, a plan includes any agreement or arrangement, including an agreement or arrangement that includes one person. In addition, references to deferred compensation are treated as including references to income (whether actual or notional) attributable to deferred compensation or income. However, compensation is not treated as deferred for purposes of the proposal if the service provider receives payment of the compensation not later than two and one-half months after the end of the service recipient's taxable year during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture (within the meaning of the proposal).

Additional rules

The Secretary of Treasury is directed to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal, including regulations disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of the proposal.

Except as provided by the Secretary of the Treasury, for purposes of the proposal, rules similar to the controlled group rules for qualified retirement plans apply.[617]

Under the proposal, the present-law general rules for nonqualified deferred compensation and the present-law rules for nonqualified deferred compensation from certain tax indifferent parties are repealed. In addition, the present-law rules for eligible and ineligible deferred compensation plans of tax-exempt employers and for ineligible deferred compensation plans of State and local governments do not apply with respect to deferred amounts attributable to services performed after December 31, 2017.

In addition, the proposal applies income tax reporting and withholding, as applicable, to amounts required to be included in gross income of employees and other service providers, including nonresident aliens subject to U.S. taxation.

Effective Date

The proposal generally applies to amounts attributable to services performed after December 31, 2017. In the case of any deferred compensation amount to which the proposal does not otherwise apply solely by reason of the fact that the amount is attributable to services performed before January 1, 2018, to the extent such amount is not includible in gross income in a taxable year beginning before 2026, such amount is includible in income in the later of (1) the last taxable year before 2026, or (2) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation (determined in the same manner as determined under the proposal). Earnings on deferred amounts attributable to services performed before January 1, 2018, are subject to the proposal only to the extent that the amounts to which the earnings are attributable are subject to the proposal.

The Secretary of the Treasury is directed to issue guidance, no later than 120 days after enactment of the proposal, providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2017, may, without violating the general rules for nonqualified deferred compensation, be amended to conform the date of distribution to the service provider to the date amounts are required to be included in income under the proposal. If the service provider-taxpayer is also a service recipient and maintains one or more nonqualified deferred compensation arrangements for its service providers under which any amount is attributable to services performed on or before December 31, 2017, the guidance is to permit any such arrangement to be amended to conform the dates of distribution under that arrangement to the date amounts are required to be included in the income of the taxpayer. An amendment to a nonqualified deferred compensation arrangement made pursuant to the guidance is not to be treated as a material modification of the arrangement for purposes of the general rules for nonqualified deferred compensation.

[617] Sec. 414(b) and (c).

2. Modification of limitation on excessive employee remuneration

Present Law

In general

An employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) provides an explicit limitation on the deductibility of compensation expenses in the case of publicly traded corporate employers. The otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation[618] is limited to no more than $1 million per year.[619] The deduction limitation applies when the deduction would otherwise be taken.

Covered employees

Section 162(m) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year and (2) the four most highly compensated officers[620] for the taxable year (other than the chief executive officer). Treasury regulations under section 162(m) provide that whether an employee is the chief executive officer or among the four most highly compensated officers should be determined pursuant to the executive compensation disclosure rules promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

In 2006, the Securities and Exchange Commission amended certain rules relating to executive compensation, including which officers' compensation must be disclosed under the Exchange Act. Under the new rules, such officers are (1) the principal executive officer (or an individual acting in such capacity), (2) the principal financial officer (or an individual acting in such capacity), and (3) the three most highly compensated officers,[621] other than the principal executive officer or principal financial officer.

In response to the Securities and Exchange Commission's new disclosure rules, the Internal Revenue Service issued updated guidance on identifying which employees are covered by section 162(m).[622] The new guidance provides that "covered employee" means any employee who is (1) the principal executive officer (or an individual acting in such capacity) defined in

[618] A corporation is treated as publicly held if it has a class of common equity securities that is required to be registered under section 12 of the Securities Exchange Act of 1934.

[619] Sec. 162(m). This deduction limitation applies for purposes of the regular income tax and the alternative minimum tax.

[620] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[621] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[622] Notice 2007-49, 2007-25 I.R.B. 1429.

reference to the Exchange Act, or (2) among the three most highly compensated officers[623] for the taxable year (other than the principal executive officer), again defined by reference to the Exchange Act. Thus, under current guidance, only four employees are covered under section 162(m) for any taxable year. Under Treasury regulations, the requirement that the individual meet the criteria as of the last day of the taxable year applies to both the principal executive officer and the three highest compensated officers.[624]

Definition of publicly held corporation

For purposes of the deduction disallowance of section 162(m), a publicly held corporation means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934. All U.S. publicly traded companies are subject to this registration requirement, including their foreign affiliates (to the extent subject to U.S. tax). A foreign company publicly traded through American depository receipts ("ADRs") is also subject to this registration requirement if more than 50 percent of the issuer's outstanding voting securities are held, directly or indirectly, by residents of United States and either (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States. Other foreign companies are not subject to the registration requirement.

Remuneration subject to the deduction limitation

In general

Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million cap is reduced by excess parachute payments (as defined in section 280G) that are not deductible by the corporation.

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million. The following types of compensation are not taken into account: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation"); (3) payments to a tax-favored retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross

[623] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[624] Treas. Reg. sec. 1.162-27(c)(2).

income (such as employer-provided health benefits and miscellaneous fringe benefits[625]); and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993. In addition, remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (*e.g.*, is not performance-based compensation) because the payment of compensation is deferred until after termination of employment.

Performance-based compensation

Compensation qualifies for the exception for performance-based compensation only if (1) it is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee consisting solely of two or more outside directors,[626] (3) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to and approved by the shareholders in a separate majority-approved vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

Compensation (other than stock options or other stock appreciation rights ("SARs")) is not treated as paid solely on account of the attainment of one or more performance goals unless the compensation is paid to the particular executive pursuant to a pre-established objective performance formula or standard that precludes discretion. A stock option or SAR with an exercise price not less than the fair market value, on the date the option or SAR is granted, of the stock subject to the option or SAR, generally is treated as meeting the exception for performance-based compensation, provided that the requirements for outside director and shareholder approval are met (without the need for certification that the performance standards have been met). This is the case because the amount of compensation attributable to the options or SARs received by the executive would be based solely on an increase in the corporation's stock price. Stock-based compensation is not treated as performance-based if it depends on factors other than corporate performance.

Description of Proposal

Definition of covered employee

The proposal revises the definition of covered employee to include both the principal executive officer and the principal financial officer. Further, an individual is a covered employee if the individual holds one of these positions at any time during the taxable year. The proposal also defines as a covered employee the three (rather than four) most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer) who

[625] Secs. 105, 106, and 132.

[626] A director is considered an outside director if he or she is not a current employee of the corporation (or related entities), is not a former employee of the corporation (or related entities) who is receiving compensation for prior services (other than benefits under a qualified retirement plan), was not an officer of the corporation (or related entities) at any time, and is not currently receiving compensation for personal services in any capacity (*e.g.*, for services as a consultant) other than as a director.

are required to be reported on the company's proxy statement for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders).

In addition, if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years. Thus, an individual remains a covered employee with respect to compensation otherwise deductible for subsequent years, including for years during which the individual is no longer employed by the corporation and years after the individual has died. Compensation does not fail to be compensation with respect to a covered employee and thus subject to the deduction limit for a taxable year merely because the compensation is includible in the income of, or paid to, another individual, such as compensation paid to a beneficiary after the employee's death, or to a former spouse pursuant to a domestic relations order.

Definition of publicly held corporation

The proposal extends the applicability of section 162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. The proposed definition may include certain additional corporations that are not publicly traded, such as large private C or S corporations.

Performance-based compensation and commissions exceptions

The proposal eliminates the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit. Thus, such compensation is taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million and is thus not deductible under section 162.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Excise tax on excess tax-exempt organization executive compensation

Present Law

Taxable employers and other service recipients are generally allowed a deduction for reasonable compensation expenses.[627] However, in some cases, compensation in excess of specific levels is not deductible.

In the case of a publicly held corporation, subject to certain exceptions, the deduction for a taxable year for compensation of the corporation's principal executive officer or for any of the

[627] Sec. 162(a)(1).

corporation's three most highly compensated officers other than the principal executive officer is limited to $1 million ("$1 million limit on deductible compensation").[628]

A "parachute payment" (generally a payment of compensation that is contingent on a change in corporate ownership or control) made to an officer, shareholder or highly compensated individual is generally not deductible if the aggregate present value of all such payments to an individual equals or exceeds three times the individual's base amount (an "excess parachute payment").[629] An individual's base amount is the average annual compensation includible in the individual's gross income for the five taxable years ending before the date the change in ownership or control occurs. Certain amounts are not considered parachute payments, including payments under a qualified retirement plan, a simplified employee pension plan, or a simple retirement account.[630]

These deduction limits generally do not affect a tax-exempt organization.

Description of Proposal

Under the proposal, an employer is liable for an excise tax equal to 20 percent of the sum of the (1) remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment (under a new definition for this purpose that relates solely to separation pay) paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million.

For purposes of the proposal, a covered employee is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016. An "applicable tax-exempt organization" is an organization exempt from tax under section 501(a), an exempt farmers' cooperative,[631] a Federal, State or local governmental entity with excludable income,[632] or a political organization.[633]

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[628] Sec. 162(m)(1). Under section 162(m)(6), limits apply to deductions for compensation of individuals performing services for certain health insurance providers.

[629] Sec. 280G.

[630] Secs. 401(a), 403(a), 408(k), and 408(p).

[631] Sec. 521(b).

[632] Sec. 115(1).

[633] Sec. 527(e)(1).

Remuneration means wages as defined for income tax withholding purposes,[634] but does not include any designated Roth contribution.[635] Remuneration of a covered employee includes any remuneration paid with respect to employment of the covered employee by any person or governmental entity related to the applicable tax-exempt organization. A person or governmental entity is treated as related to an applicable tax-exempt organization if the person or governmental entity (1) controls, or is controlled by, the organization, (2) is controlled by one or more persons that control the organization, (3) is a supported organization[636] during the taxable year with respect to the organization, (4) is a supporting organization[637] during the taxable year with respect to the organization, or (5) in the case of a voluntary employees' beneficiary association ("VEBA"),[638] establishes, maintains, or makes contributions to the VEBA. However, remuneration of a covered employee that is not deductible by reason of the $1 million limit on deductible compensation is not taken into account for purposes of the proposal.

Under the proposal, an excess parachute payment is the amount by which any parachute payment exceeds the portion of the base amount allocated to the payment. A parachute payment is a payment in the nature of compensation to (or for the benefit of a covered employee) if the payment is contingent on the employee's separation from employment and the aggregate present value of all such payments is three times or more the base amount. The base amount is the average annual compensation includible in the covered employee's gross income for the five taxable years ending before the date of the employee's separation from employment. Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity,[639] or an eligible deferred compensation plan of a State or local government employer.[640]

The employer of a covered employee is liable for the excise tax. If remuneration of a covered employee from more than one employer is taken into account in determining the excise tax, each employer is liable for the tax in an amount that bears the same ratio to the total tax as the remuneration paid by that employer bears to the remuneration paid by all employers to the covered employee.

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[634] Sec. 3401(a).

[635] Under section 402A(c), a designated Roth contribution is an elective deferral (that is, a contribution to a tax-favored employer-sponsored retirement plan made at the election of an employee) that the employee designates as not being excludable from income.

[636] Sec. 509(f)(3).

[637] Sec. 509(a)(3).

[638] Sec. 501(c)(9).

[639] Sec. 403(b).

[640] Sec. 457(b).

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

TITLE IV − TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

I. PRESENT LAW

Present law combines taxation of all U.S. persons on their worldwide income, whether derived in the United States or abroad, with limited deferral of taxation of income earned by foreign subsidiaries of U.S. companies and source-based taxation of the U.S.-source income of nonresident aliens and foreign entities. Under this system (sometimes described as the U.S. hybrid system), the application of the Code differs depending on whether income arises from outbound investment or inbound investment. Outbound investment refers to the foreign activities of U.S. persons, while inbound investment is investment by foreign persons in U.S. assets or activities, although certain rules are common to both inbound and outbound activities.

A. Principles Common to Inbound and Outbound Taxation

Although the U.S. tax rules differ depending on whether the activity in question is inbound or outbound, there are certain concepts that apply to both inbound and outbound investment. Such areas include the transfer pricing rules, entity classification, the rules for determination of source, and whether a corporation is foreign or domestic.

1. Residence

U.S. persons are subject to tax on their worldwide income. The Code defines U.S. person to include all U.S. citizens and residents as well as domestic entities such as partnerships, corporations, estates and certain trusts.[641] The term "resident" is defined only with respect to natural persons. Noncitizens who are lawfully admitted as permanent residents of the United States in accordance with immigration laws (colloquially referred to as green card holders) are treated as residents for tax purposes. In addition, noncitizens who meet a substantial presence test and are not otherwise exempt from U.S. taxation are also taxable as U.S. residents.[642]

For legal entities, the Code determines whether an entity is subject to U.S. taxation on its worldwide income on the basis of its place of organization. For purposes of U.S. tax law, a corporation or partnership is treated as domestic if it is organized or created under the laws of the United States or of any State, unless, in the case of a partnership, the Secretary prescribes otherwise by regulation.[643] All other partnerships and corporations (that is, those organized under the laws of foreign countries) are treated as foreign.[644] In contrast, place of organization is not determinative of residence under taxing jurisdictions that use factors such as situs, management and control to determine residence. As a result, legal entities may have more than

[641] Sec. 7701(a)(30).

[642] Sec. 7701(b).

[643] Sec. 7701(a)(4).

[644] Secs. 7701(a)(5) and 7701(a)(9). Entities organized in a possession or territory of the United States are not considered to have been organized under the laws of the United States.

one tax residence, or, in some case, no residence.[645] Only domestic corporations are subject to U.S. tax on a worldwide basis. Foreign corporations are taxed only on income that has a sufficient connection with the United States.

Tax benefits otherwise available to a domestic corporation that migrates its tax home from the United States to foreign jurisdiction may be denied to such corporation, in which case it continues to be treated as a domestic corporation for ten years following such migration.[646] These sanctions generally apply to a transaction in which, pursuant to a plan or a series of related transactions: (1) a domestic corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the domestic corporation hold (by reason of the stock they had held in the domestic corporation) at least 60 percent but less than 80 percent (by vote or value) of the stock of the foreign-incorporated entity after the transaction (this stock often being referred to as "stock held by reason of"); and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (that is, the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group.[647]

The Treasury Department and the IRS have promulgated detailed guidance, through both regulations and several notices, addressing these requirements under section 7874 since the section was enacted in 2004,[648] and have sought to expand the reach of the section or reduce the tax benefits of inversion transactions. For example, Notice 2014-52 announced Treasury's and the IRS's intention to issue regulations and took a two-pronged approached. First, it addressed the treatment of cross-border combination transactions themselves. Second, it addressed post-transaction steps that taxpayers may undertake with respect to US-owned foreign subsidiaries making it more difficult to access foreign earnings without incurring added U.S. tax. On November 19, 2015, Treasury and the IRS issued Notice 2015-79, which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance

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[645] "The notion of corporate residence is an important touchstone of taxation, however, in many foreign income tax systems[,]" with the result that the bilateral treaties are often relied upon to resolve conflicting claims of taxing jurisdiction. Joseph Isenbergh, Vol. 1 *U.S. Taxation of Foreign Persons and Foreign Income*, Para. 7.1 (Fourth Ed. 2016).

[646] Sec. 7874.

[647] Section 7874(a). In addition, an excise tax may be imposed on certain stock compensation of executives of companies that undertake inversion transactions. Sec. 4985.

[648] Notice 2015-79, 2015 I.R.B. LEXIS 583 (Nov. 19, 2015), which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance issued in Notice 2014-52. On April 4, 2016, Treasury and the IRS issued proposed and temporary regulations (T.D. 9761) that incorporate the rules previously announced in Notice 2014-52 and Notice 2015-79 and a new multiple domestic entity acquisition rule. On January 13, 2017, Treasury and the IRS issued final and temporary regulations under section 7874 (T.D. 9812), which adopt, with few changes, prior temporary and proposed regulations, which identify certain stock of an acquiring foreign corporation that is disregarded in calculating the ownership of the foreign corporation for purposes of section 7874.

issued in Notice 2014-52. In 2016, Treasury and the IRS issued proposed and temporary regulations that incorporate the rules previously announced in Notice 2014-52 and Notice 2015-79 and a new multiple domestic entity acquisition rule.[649]

In early 2017, Treasury issued final and temporary regulations[650] that adopt, with few changes, the 2016 temporary and proposed regulations.

2. Entity classification

Certain entities are eligible to elect their classification for Federal tax purposes under the "check-the-box" regulations adopted in 1997.[651] Those regulations simplified the entity classification process for both taxpayers and the IRS by making the entity classification of unincorporated entities explicitly elective in most instances.[652] The eligibility to elect and the breadth of an entity's choices depend upon whether it is a "per se corporation" and its number of beneficial owners. Foreign as well as domestic entities may make the election. As a result, it is possible for an entity that operates across countries to be treated as a hybrid entity. A hybrid entity is one which is treated as a flow-through or disregarded entity for U.S. tax purposes but as a corporation for foreign tax purposes. For "reverse hybrid entities," the opposite is true. The election can affect the determination of the source of the income, availability of tax credits, and other tax attributes.

3. Source of income rules

The rules for determining the source of certain types of income are specified in the Code and described briefly below. Various factors determine the source of income for U.S. tax purposes, including the status or nationality of the payor, the status or nationality of the recipient, the location of the recipient's activities that generate the income, and the location of the assets that generate the income. To the extent that the source of income is not specified by statute, the Treasury Secretary may promulgate regulations that explain the appropriate treatment. However,

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[649] T.D. 9761, April 4, 2016. But see, *Chamber of Commerce v Internal Revenue Service*, Cause No 1:16-CV-944-LY (W.D. Tex. Sept. 29, 20017), granting summary judgment to plaintiff in challenge to temporary regulations based on lack of compliance with Administrative Procedure Requirements.

[650] T.D. 9812, January 13, 2017.

[651] Treas. Reg. sec. 301.7701-1, *et seq.*

[652] The check-the-box regulations replaced Treas. Reg. sec. 301.7701-2, as in effect prior to 1997, under which the classification of unincorporated entities for Federal tax purposes was determined on the basis of a four characteristics indicative of status as a corporation: continuity of life, centralization of management, limited liability, and free transferability of interests. An entity that possessed three or more of these characteristics was treated as a corporation; if it possessed two or fewer, then it was treated as a partnership. Thus, to achieve characterization as a partnership under this system, taxpayers needed to arrange the governing instruments of an entity in such a way as to eliminate two of these corporate characteristics. The advent and proliferation of limited liability companies ("LLCs") under State laws allowed business owners to create customized entities that possessed a critical common feature—limited liability for investors—as well as other corporate characteristics the owners found desirable. As a consequence, classification was effectively elective for well-advised taxpayers.

many items of income are not explicitly addressed by either the Code or Treasury regulations, sometimes resulting in nontaxation of the income. On several occasions, courts have determined the source of such items by applying the rule for the type of income to which the disputed income is most closely analogous, based on all facts and circumstances.[653]

Interest

Interest is derived from U.S. sources if it is paid by the United States or any agency or instrumentality thereof, a State or any political subdivision thereof, or the District of Columbia. Interest is also from U.S. sources if it is paid by a resident or a domestic corporation on a bond, note, or other interest-bearing obligation.[654] Special rules apply to treat as foreign-source certain amounts paid on deposits with foreign commercial banking branches of U.S. corporations or partnerships and certain other amounts paid by foreign branches of domestic financial institutions.[655] Interest paid by the U.S. branch of a foreign corporation is also treated as U.S.-source income.[656]

Dividends

Dividend income is generally sourced by reference to the payor's place of incorporation.[657] Thus, dividends paid by a domestic corporation are generally treated as entirely U.S.-source income. Similarly, dividends paid by a foreign corporation are generally treated as entirely foreign-source income. Under a special rule, dividends from certain foreign corporations that conduct U.S. businesses are treated in part as U.S.-source income.[658]

Rents and royalties

Rental income is sourced by reference to the location or place of use of the leased property.[659] The nationality or the country of residence of the lessor or lessee does not affect the source of rental income. Rental income from property located or used in the United States (or from any interest in such property) is U.S.-source income, regardless of whether the property is real or personal, intangible or tangible.

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[653] See, *e.g.*, *Hunt v. Commissioner*, 90 T.C. 1289 (1988).

[654] Sec. 861(a)(1); Treas. Reg. sec. 1.861-2(a)(1).

[655] Secs. 861(a)(1) and 862(a)(1). For purposes of certain reporting and withholding obligations the source rule in section 861(a)(1)(B) does not apply to interest paid by the foreign branch of a domestic financial institution. This results in the payment being treated as a withholdable payment. Sec. 1473(1)(C).

[656] Sec. 884(f)(1).

[657] Secs. 861(a)(2), 862(a)(2).

[658] Sec. 861(a)(2)(B).

[659] Sec. 861(a)(4).

Royalties are sourced in the place of use of (or the place of privilege to use) the property for which the royalties are paid.[660] This source rule applies to royalties for the use of either tangible or intangible property, including patents, copyrights, secret processes, formulas, goodwill, trademarks, trade names, and franchises.

Income from sales of personal property

Subject to significant exceptions, income from the sale of personal property is sourced on the basis of the residence of the seller.[661] For this purpose, special definitions of the terms "U.S. resident" and "nonresident" are provided. A nonresident is defined as any person who is not a U.S. resident,[662] while the term "U.S. resident" comprises any juridical entity which is a U.S. person, all U.S. citizens, as well as any individual who is a U.S. resident without a tax home in a foreign country or a nonresident alien with a tax home in the United States.[663] As a result, nonresident includes any foreign corporation.[664]

Several special rules apply. For example, income from the sale of inventory property is generally sourced to the place of sale, which is determined by where title to the property passes.[665] However, if the sale is by a nonresident and is attributable to an office or other fixed place of business in the United States, the sale is treated as income from U.S. sources without regard to the place of sale, unless it is sold for use, disposition, or consumption outside the United States and a foreign office materially participates in the sale.[666] Income from the sale of inventory property that a taxpayer produces (in whole or in part) in the United States and sells outside the United States, or that a taxpayer produces (in whole or in part) outside the United States and sells in the United States, is treated as partly U.S.-source and partly foreign-source.[667]

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[660] *Ibid.*

[661] Sec. 865(a).

[662] Sec. 865(g)(1)(B).

[663] Sec. 865(g)(1)(A).

[664] Sec. 865(g).

[665] Secs. 865(b), 861(a)(6), 862(a)(6); Treas. Reg. sec. 1.861-7(c).

[666] Sec. 865(e)(2).

[667] Sec. 863(b). A taxpayer may elect one of three methods for allocating and apportioning income as U.S.- or foreign-source: (1) the 50-50 method under which 50 percent of the income from the sale of inventory property in such a situation is attributable to the production activities and 50 percent to the sales activities, with the income sourced based on the location of those activities; (2) independent factory price ("IFP") method under which, in certain circumstances, an IFP may be established by the taxpayer to determine income from production activities; (3) the books and records method under which, with advance permission, the taxpayer may use books of account to detail the allocation of receipts and expenditures between production and sales activities. Treas. Reg. sec. 1.863-3(b), (c). If production activity occurs only within the United States, or only within foreign countries, then all income is sourced to where the production activity occurs; when production activities occur in both the United States and one or more foreign countries, the income attributable to production activities must be split between U.S.

In determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS has taken the position that to the extent that there is unrealized gain attributable to partnership assets that are effectively connected with the U.S. business, the foreign person's gain or loss from the sale or exchange of a partnership interest is effectively connected gain or loss to the extent of the partner's distributive share of such unrealized gain or loss, and not capital gain or loss. Similarly, to the extent that the partner's distributive share of unrealized gain is attributable to a permanent establishment of the partnership under an applicable treaty provision, it may be subject to U.S. tax under a treaty.[668]

Gain on the sale of depreciable property is divided between U.S.-source and foreign-source in the same ratio that the depreciation was previously deductible for U.S. tax purposes.[669] Payments received on sales of intangible property are sourced in the same manner as royalties to the extent the payments are contingent on the productivity, use, or disposition of the intangible property.[670]

Personal services income

Compensation for labor or personal services is generally sourced to the place-of-performance. Thus, compensation for labor or personal services performed in the United States generally is treated as U.S.-source income, subject to an exception for amounts that meet certain *de minimis* criteria.[671] Compensation for services performed both within and without the United States is allocated between U.S.-and foreign-source.[672]

Insurance income

Underwriting income from issuing insurance or annuity contracts generally is treated as U.S.-source income if the contract involves property in, liability arising out of an activity in, or the lives or health of residents of, the United States.[673]

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and foreign sources. Treas. Reg. sec. 1.863-3(c)(1). The sales activity is generally sourced based on where title to the property passes. Treas. Reg. secs. 1.863-3(c)(2), 1.861-7(c).

[668] Rev. Rul. 91-32, 1991-1 C.B. 107. But see, Grecian Magnesite Mining, Industrial & Shipping Co. SA v Commissioner, 149 T.C. No. 3 (2017).

[669] Sec. 865(c).

[670] Sec. 865(d).

[671] Sec. 861(a)(3). Gross income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship is generally treated as foreign-source income.

[672] Treas. Reg. sec. 1.861-4(b).

[673] Sec. 861(a)(7).

Transportation income

Sources rules generally provide that income from furnishing transportation that both begins and ends in the United States is U.S.-source income,[674] and 50-percent of income attributable to transportation that either begins or the ends in the United States is treated as U.S.-source income. However, to the extent that the operator of a shipping or cruise line is foreign, its ownership structure and the maritime law[675] applicable for determining what constitutes international shipping as well as specific income tax provisions combine to create an industry-specific departure from the rules generally applicable.[676]

Income from space or ocean activities or international communications

In the case of a foreign person, generally no income from a space or ocean activity or from international communications is treated as U.S.-source income.[677] With respect to the latter, an exception is provided if the foreign person maintains an office or other fixed place of business in the United States, in which case the international communications income attributable to such fixed place of business is treated as U.S.-source income.[678] For U.S. persons, all income from space or ocean activities and 50 percent of income from international communications is treated as U.S.-source income.

Amounts received with respect to guarantees of indebtedness

Amounts received, directly or indirectly, from a noncorporate resident or from a domestic corporation for the provision of a guarantee of indebtedness of such person are income from U.S.

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[674] Sec. 863(c).

[675] U.S. law on navigation is codified in U.S. Code at title 33, and is in turn consistent with the body of international maritime law. The normative principles of international maritime law for determining the maritime zones and territorial sovereignty over seas are embodied in the United Nations Convention on the Law of the Sea, first opened for signature in 1982. Since 1983, the Executive Branch has agreed that the treaty is generally consistent with existing international norms of the law of the sea and that the United States would act in conformity to the principles of the treaty other than those portions regarding deep seabed exploitation, even in the absence of ratification of the treaty.

[676] Due to the regulatory framework for aviation, an international flight must either originate or conclude in the country of residence of the airline's owner, where income tax for the international flight is assessed. In contrast to international shipping, international aviation cannot be carried out using flags-of-convenience. Thus, although tax law treats shipping and aviation similarly, the differences between the two industries and the applicable regulatory regimes produce different tax outcomes. Full territorial sovereignty applies within 12 nautical miles of one's coast; the contiguous waters beyond 12 nautical miles but up to 24 nautical miles are subject to some regulation. Within 200 nautical miles, a country may assert an economic zone for exploitation of living marine resources and some minerals. Beyond 200 nautical miles are the "high seas" in which no sovereign state may assert exclusive jurisdiction.

[677] Sec. 863(d).

[678] Sec. 863(e).

sources.[679] This includes payments that are made indirectly for the provision of a guarantee. For example, U.S.-source income under this rule includes a guarantee fee paid by a foreign bank to a foreign corporation for the foreign corporation's guarantee of indebtedness owed to the bank by the foreign corporation's domestic subsidiary, where the cost of the guarantee fee is passed on to the domestic subsidiary through, for instance, additional interest charged on the indebtedness. In this situation, the domestic subsidiary has paid the guarantee fee as an economic matter through higher interest costs, and the additional interest payments made by the subsidiary are treated as indirect payments of the guarantee fee and, therefore, as income from U.S. sources.

Such U.S.-source income also includes amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of indebtedness of that foreign person if the payments received are connected with income of such person that is effectively connected with the conduct of a U.S. trade or business. Amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of that person's debt, are treated as foreign-source income if they are not from sources within the United States under section 861(a)(9).

4. Intercompany transfers

Transfer pricing

A basic U.S. tax principle applicable in dividing profits from transactions between related taxpayers is that the amount of profit allocated to each related taxpayer must be measured by reference to the amount of profit that a similarly situated taxpayer would realize in similar transactions with unrelated parties. The transfer pricing rules of section 482 and the accompanying Treasury regulations are intended to preserve the U.S. tax base by ensuring that taxpayers do not shift income properly attributable to the United States to a related foreign company through pricing that does not reflect an arm's-length result.[680] Similarly, the domestic laws of most U.S. trading partners include rules to limit income shifting through transfer pricing. The arm's-length standard is difficult to administer in situations in which no unrelated party market prices exist for transactions between related parties. When a foreign person with U.S. activities has transactions with related U.S. taxpayers, the amount of income attributable to U.S. activities is determined in part by the same transfer pricing rules of section 482 that apply when U.S. persons with foreign activities transact with related foreign taxpayers.

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[679] Sec. 861(a)(9). This provision effects a legislative override of the opinion in *Container Corp. v. Commissioner*, 134 T.C. 122 (February 17, 2010), aff'd 2011 WL1664358, 107 A.F.T.R.2d 2011-1831 (5th Cir. May 2, 2011), in which the Tax Court held that fees paid by a domestic corporation to its foreign parent with respect to guarantees issued by the parent for the debts of the domestic corporation were more closely analogous to compensation for services than to interest, and determined that the source of the fees should be determined by reference to the residence of the foreign parent-guarantor. As a result, the income was treated as income from foreign sources.

[680] For a detailed description of the U.S. transfer pricing rules, see Joint Committee on Taxation, *Present Law and Background Related to Possible Income Shifting and Transfer Pricing* (JCX-37-10), July 20, 2010, pp. 18-50.

Section 482 authorizes the Secretary of the Treasury to allocate income, deductions, credits, or allowances among related business entities[681] when necessary to clearly reflect income or otherwise prevent tax avoidance, and comprehensive Treasury regulations under that section adopt the arm's-length standard as the method for determining whether allocations are appropriate.[682] The regulations generally attempt to identify the respective amounts of taxable income of the related parties that would have resulted if the parties had been unrelated parties dealing at arm's length. For income from intangible property, section 482 provides "in the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible." By requiring inclusion in income of amounts commensurate with the income attributable to the intangible, Congress was responding to concerns regarding the effectiveness of the arm's-length standard with respect to intangible property—including, in particular, high-profit-potential intangibles.[683]

<u>Gain recognition on outbound transfers</u>

If a transfer of intangible property to a foreign affiliate occurs in connection with certain corporate transactions, nonrecognition rules that may otherwise apply are suspended. The transferor of intangible property must recognize gain from the transfer as though he had sold the intangible (regardless of the stage of development of the intangible property) in exchange for payments contingent on the use, productivity or disposition of the transferred property in amounts that would have been received either annually over the useful life of the property or upon disposition of the property after the transfer.[684] The appropriate amounts of those imputed payments are determined using transfer-pricing principles. Final regulations issued in 2016 eliminate an exception under temporary regulations that permitted nonrecognition of gain from outbound transfers of foreign goodwill and going concern value. However, the Secretary announced that reinstatement of an exception for active trade or business is under consideration for cases with little potential for abuse and administrative difficulties.[685]

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[681] The term "related" as used herein refers to relationships described in section 482, which refers to "two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests."

[682] Section 1059A buttresses section 482 by limiting the extent to which costs used to determine custom valuation can also be used to determine basis in property imported from a related party. A taxpayer that imports property from a related party may not assign a value to the property for cost purposes that exceeds its customs value.

[683] H.R. Rep. No. 99-426, p. 423.

[684] Sec. 367(d).

[685] See, T.D. 9803, 81 F.R. 91012 (December 17, 2016). Treas. Reg. sec. 1.367(d)-1(b) <u>Property subject to section 367(d)</u>, now provides that the rules of section 367(d) apply to transfers of intangible property as defined under Treas. Sec. 1.367(a)-1(d)(5) after September 14, 2015, and to any transfers occurring before that date resulting from entity classification elections filed on or after September 15, 2015. Noting that commenters on the regulations had cited legislative history that contemplated active business exceptions, Treasury announced the reconsideration of the rule. U.S. Treasury Department, *Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, Executive Order 13789* October 2, 2017, TNT Doc 2017-72131. The relevant legislative history is found

B. U.S. Tax Rules Applicable to Nonresident Aliens and Foreign Corporations (Inbound)

Nonresident aliens and foreign corporations are generally subject to U.S. tax only on their U.S.-source income. Thus, the source and type of income received by a foreign person generally determines whether there is any U.S. income tax liability and the mechanism by which it is taxed. The U.S. tax rules for U.S. activities of foreign taxpayers apply differently to two broad types of income: U.S.-source income that is "fixed or determinable annual or periodical gains, profits, and income" ("FDAP income") or income that is "effectively connected with the conduct of a trade or business within the United States" ("ECI"). FDAP income generally is subject to a 30-percent gross-basis tax withheld at its source, while ECI is generally subject to the same U.S. tax rules that apply to business income derived by U.S. persons. That is, deductions are permitted in determining taxable ECI, which is then taxed at the same rates applicable to U.S. persons. Much FDAP income and similar income is, however, exempt from tax or is subject to a reduced rate of tax under the Code[686] or a bilateral income tax treaty.[687]

1. Gross-basis taxation of U.S.-source income

Non-business income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30 percent, which is collected by withholding at the source of the payment. As explained below, the categories of income subject to the 30-percent tax and the categories for which withholding is required are generally coextensive, with the result that determining the withholding tax liability determines the substantive liability.

The income of non-resident aliens or foreign corporations that is subject to tax at a rate of 30-percent includes FDAP income that is not effectively connected with the conduct of a U.S. trade or business.[688] The items enumerated in defining FDAP income are illustrative; the common characteristic of types of FDAP income is that taxes with respect to the income may be readily computed and collected at the source, in contrast to the administrative difficulty involved in determining the seller's basis and resulting gain from sales of property.[689] The words "annual or periodical" are "merely generally descriptive" of the payments that could be within the

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at in H.R. Rep. No. 98-432, 98th Cong., 2d Sess. 1318-1320 (March 5, 1984) and Conference Report, H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 951-957 (June 23, 1984).

[686] *E.g.*, the portfolio interest exception in section 871(h) (discussed below).

[687] Because each treaty reflects considerations unique to the relationship between the two treaty countries, treaty withholding tax rates on each category of income are not uniform across treaties.

[688] Secs. 871(a), 881. If the FDAP income is also ECI, it is taxed on a net basis, at graduated rates.

[689] *Commissioner v. Wodehouse,* 337 U.S. 369, 388-89 (1949). After reviewing legislative history of the Revenue Act of 1936, the Supreme Court noted that Congress expressly intended to limit taxes on nonresident aliens to taxes that could be readily collectible, *i.e.*, subject to withholding, in response to "a theoretical system impractical of administration in a great number of cases. H.R. Rep. No. 2475, 74th Cong., 2d Sess. 9-10 (1936)." In doing so, the Court rejected P.G. Wodehouse's arguments that an advance royalty payment was not within the purview of the statutory definition of FDAP income.

purview of the statute and do not preclude application of the withholding tax to one-time, lump sum payments to nonresident aliens.[690]

With respect to income from shipping, the gross basis tax potentially applicable is four percent,[691] unless the income is effectively connected with a U.S. trade or business, and thus subject to the graduated rates, as determined under rules specific to U.S.-source gross transportation income rather than the more broadly applicable rules defining effectively connected income in section 864(c). Even if the income is within the purview of those special rules, it may nevertheless be exempt if the income is derived from the international operation of a ship or aircraft by a foreign entity organized in a jurisdiction which provides a reciprocal exemption to U.S. entities.[692]

Types of FDAP income

FDAP income encompasses a broad range of types of gross income, but has limited application to gains on sales of property, including market discount on bonds and option premiums.[693] Capital gains received by nonresident aliens present in the United States for fewer than 183 days are generally treated as foreign source and are thus not subject to U.S. tax, unless the gains are effectively connected with a U.S. trade or business; capital gains received by nonresident aliens present in the United States for 183 days or more[694] that are treated as income from U.S. sources are subject to gross-basis taxation.[695] In contrast, U.S-source gains from the sale or exchange of intangibles are subject to tax and withholding if they are contingent upon the productivity of the property sold and are not effectively connected with a U.S. trade or business.[696]

Interest on bank deposits may qualify for exemption on two grounds, depending on where the underlying principal is held on deposit. Interest paid with respect to deposits with domestic

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[690] *Commissioner v. Wodehouse,* 337 U.S. 369, 393 (1949).

[691] Sec. 887.

[692] Sec. 883(a)(1). In addition, to the extent provided in regulations, income from shipping and aviation is not subject to the four-percent gross basis tax if the income is of a type that is not subject to the reciprocal exemption for net basis taxation. See sec. 887(b)(1). Comparable rules under section 872(b)(1) apply to income of nonresident alien individuals from shipping operations.

[693] Although technically insurance premiums paid to a foreign insurer or reinsurer are FDAP income, they are exempt from withholding under Treas. Reg. sec. 1.1441-2(a)(7) if the insurance contract is subject to the excise tax under section 4371. Treas. Reg. secs. 1.1441-2(b)(1)(i) and 1.1441-2(b)(2).

[694] For purposes of this rule, whether a person is considered a resident in the United States is determined by application of the rules under section 7701(b).

[695] Sec. 871(a)(2). In addition, certain capital gains from sales of U.S. real property interests are subject to tax as effectively connected income (or in some instances as dividend income) under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA").

[696] Secs. 871(a)(1)(D), 881(a)(4).

banks and savings and loan associations, and certain amounts held by insurance companies, are U.S.-source income but are not subject to the U.S. tax when paid to a foreign person, unless the interest is effectively connected with a U.S. trade or business of the recipient.[697] Interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not treated as U.S.-source income and is thus exempt from U.S. tax (regardless of whether the recipient is engaged in a U.S. trade or business).[698] Similarly, interest and original issue discount on certain short-term obligations is also exempt from U.S. tax when paid to a foreign person.[699] Additionally, there is generally no information reporting required with respect to payments of such amounts.[700]

Although FDAP income includes U.S.-source portfolio interest, such interest is specifically exempt from the 30-percent gross-basis tax. Portfolio interest is any interest (including original issue discount) that is paid on an obligation that is in registered form and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the beneficial owner is not a U.S. person.[701] For obligations issued before March 19, 2012, portfolio interest also includes interest paid on an obligation that is not in registered form, provided that the obligation is shown to be targeted to foreign investors under the conditions sufficient to establish deductibility of the payment of such interest.[702] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[703] certain contingent interest,[704] interest received by a controlled foreign corporation from a related person,[705] or

[697] Secs. 871(i)(2)(A), 881(d); Treas. Reg. sec. 1.1441-1(b)(4)(ii).

[698] Sec. 861(a)(1)(B); Treas. Reg. sec. 1.1441-1(b)(4)(iii).

[699] Secs. 871(g)(1)(B), 881(a)(3); Treas. Reg. sec. 1.1441-1(b)(4)(iv).

[700] Treas. Reg. sec. 1.1461-1(c)(2)(ii)(A), (B). Regulations require a bank to report interest if the recipient is a nonresident alien who resides in a country with which the United States has a satisfactory exchange of information program under a bilateral agreement and the deposit is maintained at an office in the United States. Treas. Reg. secs. 1.6049-4(b)(5) and 1.6049-8. The IRS publishes lists of the countries whose residents are subject to the reporting requirements, and those countries with respect to which the reported information will be automatically exchanged. Rev. Proc. 2017-31, available at https://www.irs.gov/pub/irs-drop/rp-17-31.pdf, supplementing Rev. Proc. 2014-64.

[701] Sec. 871(h)(2).

[702] Sec. 163(f)(2)(B). The exception to the registration requirements for foreign targeted securities was repealed in 2010, effective for obligations issued two years after enactment, thus narrowing the portfolio interest exemption for obligations issued after March 18, 2012. See Hiring Incentives to Restore Employment Law of 2010, Pub. L. No. 111-147, sec. 502(b).

[703] Sec. 871(h)(3).

[704] Sec. 871(h)(4).

[705] Sec. 881(c)(3)(C).

interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business.[706]

Imposition of gross-basis tax and reporting by U.S. withholding agents

The 30-percent tax on FDAP income is generally collected by means of withholding.[707] Withholding on FDAP payments to foreign payees is required unless the withholding agent,[708] *i.e.*, the person making the payment to the foreign person receiving the income, can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under an income tax treaty.[709] The principal statutory exemptions from the 30-percent tax apply to interest on bank deposits, and portfolio interest, described above.[710]

In many instances, the income subject to withholding is the only income of the foreign recipient that is subject to any U.S. tax. No U.S. Federal income tax return from the foreign recipient is required with respect to the income from which tax was withheld, if the recipient has no ECI income and the withholding is sufficient to satisfy the recipient's liability. Accordingly, although the 30-percent gross-basis tax is a withholding tax, it is also generally the final tax liability of the foreign recipient (unless the foreign recipients files for a refund).

A withholding agent that makes payments of U.S.-source amounts to a foreign person is required to report and pay over any amounts of U.S. tax withheld. The reports are due to be filed with the IRS by March 15 of the calendar year following the year in which the payment is made. Two types of reports are required: (1) a summary of the total U.S.-source income paid and withholding tax withheld on foreign persons for the year and (2) a report to both the IRS and the foreign person of that person's U.S.-source income that is subject to reporting.[711] The nonresident withholding rules apply broadly to any financial institution or other payor, including foreign financial institutions.[712]

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[706] Sec. 881(c)(3)(A).

[707] Secs. 1441, 1442.

[708] Withholding agent is defined broadly to include any U.S. or foreign person that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding. Treas. Reg. sec. 1.1441-7(a).

[709] Secs. 871, 881, 1441, 1442; Treas. Reg. sec. 1.1441-1(b).

[710] A reduced rate of withholding of 14 percent applies to certain scholarships and fellowships paid to individuals temporarily present in the United States. Sec. 1441(b). In addition to statutory exemptions, the 30-percent tax with respect to interest, dividends and royalties may be reduced or eliminated by a tax treaty between the United States and the country in which the recipient of income otherwise subject to tax is resident.

[711] Treas. Reg. sec. 1.1461-1(b), (c).

[712] See Treas. Reg. sec. 1.1441-7(a) (definition of withholding agent includes foreign persons).

To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the recipient of the income.[713] If the agent withholds more than is required, and results in an overpayment of tax, the excess may be refunded to the recipient of the income upon filing of a timely claim for refund.

Excise tax on foreign reinsurance premiums

An excise tax applies to premiums paid to foreign insurers and reinsurers covering U.S. risks.[714] The excise tax is imposed on a gross basis at the rate of one percent on reinsurance and life insurance premiums, and at the rate of four percent on property and casualty insurance premiums. The excise tax does not apply to premiums that are effectively connected with the conduct of a U.S. trade or business or that are exempted from the excise tax under an applicable income tax treaty. The excise tax paid by one party cannot be credited if, for example, the risk is reinsured with a second party in a transaction that is also subject to the excise tax.

Many U.S. tax treaties provide an exemption from the excise tax, including the treaties with Germany, Japan, Switzerland, and the United Kingdom.[715] To prevent persons from inappropriately obtaining the benefits of exemption from the excise tax, the treaties generally include an anti-conduit rule. The most common anti-conduit rule provides that the treaty exemption applies to the excise tax only to the extent that the risks covered by the premiums are not reinsured with a person not entitled to the benefits of the treaty (or any other treaty that provides exemption from the excise tax).[716]

2. Net-basis taxation of U.S.-source income

The United States taxes on a net basis the income of foreign persons that is "effectively connected" with the conduct of a trade or business in the United States.[717] Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is

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[713] Sec. 1462.

[714] Secs. 4371-4374.

[715] Generally, when a foreign person qualifies for benefits under such a treaty, the United States is not permitted to collect the insurance premiums excise tax from that person.

[716] In Rev. Rul. 2008-15, 2008-1 C.B. 633, the IRS provided guidance to the effect that the excise tax is imposed separately on each reinsurance policy covering a U.S. risk. Thus, if a U.S. insurer or reinsurer reinsures a U.S. risk with a foreign reinsurer, and that foreign reinsurer in turn reinsures the risk with a second foreign reinsurer, the excise tax applies to both the premium to the first foreign reinsurer and the premium to the second foreign reinsurer. In addition, if the first foreign reinsurer is resident in a jurisdiction with a tax treaty containing an excise tax exemption, the revenue ruling provides that the excise tax still applies to both payments to the extent that the transaction violates an anti-conduit rule in the applicable tax treaty. Even if no violation of an anti-conduit rule occurs, under the revenue ruling, the excise tax still applies to the premiums paid to the second foreign reinsurer, unless the second foreign reinsurer is itself entitled to an excise tax exemption.

[717] Secs. 871(b), 882.

not taken into account in determining the rates of U.S. tax applicable to the person's income from the business.[718]

U.S. trade or business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in the conduct of a trade or business within the United States if the partnership, estate, or trust is so engaged.[719]

The question whether a foreign person is engaged in a U.S. trade or business is factual and has generated much case law. Basic issues include whether the activity constitutes business rather than investing, whether sufficient activities in connection with the business are conducted in the United States, and whether the relationship between the foreign person and persons performing functions in the United States in respect of the business is sufficient to attribute those functions to the foreign person.

The trade or business rules differ from one activity to another. The term "trade or business within the United States" expressly includes the performance of personal services within the United States.[720] If, however, a nonresident alien individual performs personal services for a foreign employer, and the individual's total compensation for the services and period in the United States are minimal ($3,000 or less in total compensation and 90 days or fewer of physical presence in a year), the individual is not considered to be engaged in a U.S. trade or business.[721] Detailed rules govern whether trading in stocks or securities or commodities constitutes the conduct of a U.S. trade or business.[722] A foreign person who trades in stock or securities or commodities in the United States through an independent agent generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out. A foreign person who trades stock or securities or commodities for the person's own account also generally is not considered to be engaged in a U.S. business so long as the foreign person is not a dealer in stock or securities or commodities.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Under each treaty, the United States is permitted to tax business profits only to the extent those profits are attributable to a U.S. permanent establishment of the foreign person. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business. For example,

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[718] Secs. 871(b)(2), 882(a)(2).

[719] Sec. 875.

[720] Sec. 864(b).

[721] Sec. 864(b)(1).

[722] Sec. 864(b)(2).

a permanent establishment typically requires the maintenance of a fixed place of business over a significant period of time.

Effectively connected income

A foreign person that is engaged in the conduct of a trade or business within the United States is subject to U.S. net-basis taxation on the income that is "effectively connected" with the business. Specific statutory rules govern whether income is ECI.[723]

In the case of U.S.-source capital gain and U.S.-source income of a type that would be subject to gross basis U.S. taxation, the factors taken into account in determining whether the income is ECI include whether the income is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests).[724] Under the asset use and business activities tests, due regard is given to whether the income, gain, or asset was accounted for through the U.S. trade or business. All other U.S.-source income is treated as ECI.[725]

A foreign person who is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered to be ECI.[726] Foreign-source income not included in one of these categories (described next) generally is exempt from U.S. tax.

A foreign person's income from foreign sources generally is considered to be ECI only if the person has an office or other fixed place of business within the United States to which the income is attributable and the income is in one of the following categories: (1) rents or royalties for the use of patents, copyrights, secret processes or formulas, good will, trade-marks, trade brands, franchises, or other like intangible properties derived in the active conduct of the trade or business; (2) interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; or (3) income derived from the sale or exchange (outside the United States), through the U.S. office or fixed place of business, of inventory or property held by the foreign person primarily for sale to customers in the ordinary course of the trade or business, unless the sale or exchange is for use, consumption, or disposition outside the United States and an office or other fixed place of business of the foreign person in a foreign country participated materially in the sale or exchange.[727] Foreign-source dividends, interest, and royalties are not treated as ECI if the items are paid by a foreign

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[723] Sec. 864(c).

[724] Sec. 864(c)(2).

[725] Sec. 864(c)(3).

[726] This income is subject to net-basis U.S. taxation after allowance of a credit for any foreign income tax imposed on the income. Sec. 906.

[727] Sec. 864(c)(4)(B).

corporation more than 50 percent (by vote) of which is owned directly, indirectly, or constructively by the recipient of the income.[728]

In determining whether a foreign person has a U.S. office or other fixed place of business, the office or other fixed place of business of an agent generally is disregarded. The place of business of an agent other than an independent agent acting in the ordinary course of business is not disregarded, however, if the agent either has the authority (regularly exercised) to negotiate and conclude contracts in the name of the foreign person or has a stock of merchandise from which he regularly fills orders on behalf of the foreign person.[729] If a foreign person has a U.S. office or fixed place of business, income, gain, deduction, or loss is not considered attributable to the office unless the office was a material factor in the production of the income, gain, deduction, or loss and the office regularly carries on activities of the type from which the income, gain, deduction, or loss was derived.[730]

Special rules apply in determining the ECI of an insurance company. The foreign-source income of a foreign corporation that is subject to tax under the insurance company provisions of the Code is treated as ECI if the income is attributable to its United States business.[731]

Income, gain, deduction, or loss for a particular year generally is not treated as ECI if the foreign person is not engaged in a U.S. trade or business in that year.[732] If, however, income or gain taken into account for a taxable year is attributable to the sale or exchange of property, the performance of services, or any other transaction that occurred in a prior taxable year, the determination whether the income or gain is taxable on a net basis is made as if the income were taken into account in the earlier year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the later taxable year.[733] If any property ceases to be used or held for use in connection with the conduct of a U.S. trade or business and the property is disposed of within 10 years after the cessation, the determination whether any income or gain attributable to the disposition of the property is taxable on a net basis is made as if the disposition occurred immediately before the property ceased to be used or held for use in connection with the conduct of a U.S. trade or business and without regard to the requirement that the taxpayer be engaged in a U.S. business during the taxable year for which the income or gain is taken into account.[734]

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[728] Sec. 864(c)(4)(D)(i).

[729] Sec. 864(c)(5)(A).

[730] Sec. 864(c)(5)(B).

[731] Sec. 864(c)(4)(C).

[732] Sec. 864(c)(1)(B).

[733] Sec. 864(c)(6).

[734] Sec. 864(c)(7).

Transportation income from U.S. sources is treated as effectively connected with a foreign person's conduct of a U.S. trade or business only if the foreign person has a fixed place of business in the United States that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation.[735] If the transportation income is effectively connected with conduct of a U.S. trade or business, the transportation income, along with transportation income that is from U.S. sources because the transportation both begins and ends in the United States, may be subject to net-basis taxation. Income from the international operation of a ship or aircraft may be eligible for an exemption under section 883, provided that the foreign jurisdiction has extended reciprocity for U.S. businesses[736]; whether the party claiming an exemption is eligible for the tax relief[737]; and the activities that give rise to the income qualify under relevant regulations.

Allowance of deductions

Taxable ECI is computed by taking into account deductions associated with gross ECI. For this purpose, the apportionment and allocation of deductions is addressed in detailed regulations. The regulations applicable to deductions other than interest expense set forth general guidelines for allocating deductions among classes of income and apportioning deductions between ECI and non-ECI. In some circumstances, deductions may be allocated on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries paid, space used, time spent, or gross income received. More specific guidelines are provided for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. Detailed regulations under section 861 address the allocation and apportionment of interest deductions. In general, interest is allocated and apportioned based on assets rather than income.

3. Special rules

FIRPTA

A foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") is treated as ECI and, therefore, as taxable at the income tax rates applicable to U.S. persons, including the rates for net capital gain. A foreign person subject to tax on this income is

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[735] Sec. 887(b)(4).

[736] The most recent compilation of countries that the United States recognizes as providing exemptions lists countries in three groups: Twenty-seven countries are eligible for exemption on the basis of a review of the legislation in the foreign jurisdiction; 39 nations exchanged diplomatic notes with the United States that grant exemption to some extent; and more than 50 nations are parties with the United States to bilateral income tax treaties that include a shipping article. Rev. Rul. 2008-17, 2008-1 C.B. 626, modified by Ann. 2008-57, 2008-C.B. 1192, 2008.

[737] Sec. 883(c) and regulations thereunder.

required to file a U.S. tax return under the normal rules relating to receipt of ECI.[738] In the case of a foreign corporation, the gain from the disposition of a USRPI may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate).

The payor of income that FIRPTA treats as ECI ("FIRPTA income") is generally required to withhold U.S. tax from the payment.[739] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's total ECI and deductions (if any) for the taxable year.

Branch profits taxes

A domestic corporation owned by foreign persons is subject to U.S. income tax on its net income. The earnings of the domestic corporation are subject to a second tax, this time at the shareholder level, when dividends are paid. As described previously, when the shareholders are foreign, the second-level tax is imposed at a flat rate and collected by withholding. Unless the portfolio interest exemption or another exemption applies, interest payments made by a domestic corporation to foreign creditors are likewise subject to U.S. tax. To approximate these second-level withholding taxes imposed on payments made by domestic subsidiaries to their foreign parent corporations, the United States taxes a foreign corporation that is engaged in a U.S. trade or business through a U.S. branch on amounts of U.S. earnings and profits that are shifted out of, or amounts of interest that are deducted by, the U.S. branch of the foreign corporation. These branch taxes may be reduced or eliminated under an applicable income tax treaty.[740]

Under the branch profits tax, the United States imposes a tax of 30 percent on a foreign corporation's "dividend equivalent amount."[741] The dividend equivalent amount generally is the earnings and profits of a U.S. branch of a foreign corporation attributable to its ECI.[742] Limited categories of earnings and profits attributable to a foreign corporation's ECI are excluded in calculating the dividend equivalent amount.[743]

In arriving at the dividend equivalent amount, a branch's effectively connected earnings and profits are adjusted to reflect changes in a branch's U.S. net equity (that is, the excess of the branch's assets over its liabilities, taking into account only amounts treated as connected with its U.S. trade or business).[744] The first adjustment reduces the dividend equivalent amount to the

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738 Sec. 897(a).

739 Sec. 1445 and Treasury regulations thereunder.

740 See Treas. Reg. sec. 1.884-1(g), -5.

741 Sec. 884(a).

742 Sec. 884(b).

743 See sec. 884(d)(2) (excluding, for example, earnings and profits attributable to gain from the sale of domestic corporation stock that constitutes a U.S. real property interest described in section 897.

744 Sec. 884(b).

extent the branch's earnings are reinvested in trade or business assets in the United States (or reduce U.S. trade or business liabilities). The second adjustment increases the dividend equivalent amount to the extent prior reinvested earnings are considered remitted to the home office of the foreign corporation.

Interest paid by a U.S. trade or business of a foreign corporation generally is treated as if paid by a domestic corporation and therefore is subject to U.S. 30-percent withholding tax (if the interest is paid to a foreign person and a Code or treaty exemption or reduction would not be available if the interest were actually paid by a domestic corporation).[745] Certain "excess interest" of a U.S. trade or business of a foreign corporation is treated as if paid by a U.S. corporation to a foreign parent and, therefore, is subject to U.S. 30-percent withholding tax.[746] For this purpose, excess interest is the excess of the interest expense of the foreign corporation apportioned to the U.S. trade or business over the amount of interest paid by the trade or business.

Earnings stripping

Taxpayers are limited in their ability to reduce the U.S. tax on the income derived from their U.S. operations through certain earnings stripping transactions involving interest payments. If the payor's debt-to-equity ratio exceeds 1.5 to 1 (a debt-to-equity ratio of 1.5 to 1 or less is considered a "safe harbor"), a deduction for disqualified interest paid or accrued by the payor in a taxable year is generally disallowed to the extent of the payor's excess interest expense.[747] Disqualified interest includes interest paid or accrued to related parties when no Federal income tax is imposed with respect to such interest;[748] to unrelated parties in certain instances in which a related party guarantees the debt ("guaranteed debt"); or to a REIT by a taxable REIT subsidiary of that REIT. Excess interest expense is the amount by which the payor's net interest expense (that is, the excess of interest paid or accrued over interest income) exceeds 50 percent of its adjusted taxable income (generally taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Interest amounts disallowed under these rules can be carried forward indefinitely and are allowed as a deduction to the extent of excess limitation in a subsequent tax year. In addition, any excess limitation (that is, the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.

745 Sec. 884(f)(1)(A).

746 Sec. 884(f)(1)(B).

747 Sec. 163(j).

748 If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed under the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

C. U.S. Tax Rules Applicable to Foreign Activities of U.S. Persons (Outbound)

1. In general

In general, income earned directly by a U.S. person from the conduct of a foreign business is taxed on a current basis,[749] but income earned indirectly from a separate legal entity operating the foreign business is not. Instead, active foreign business income earned by a U.S. person indirectly through an interest in a foreign corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. person. Certain anti-deferral regimes may cause the U.S. owner to be taxed on a current basis in the United States on certain categories of passive or highly mobile income earned by the foreign corporation regardless of whether the income has been distributed as a dividend to the U.S. owner. The main anti-deferral regimes that provide such exceptions are the controlled foreign corporation ("CFC") rules of subpart F[750] and the passive foreign investment company ("PFIC") rules.[751] A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether the income is earned directly by the domestic corporation, repatriated as an actual dividend, or included in the domestic parent corporation's income under one of the anti-deferral regimes.[752]

2. Anti-deferral regimes

Subpart F

Subpart F,[753] applicable to CFCs and their shareholders, is the main anti-deferral regime of relevance to a U.S.-based multinational corporate group. A CFC generally is defined as any foreign corporation if U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that are within the meaning of the term "United States shareholder," which refers only to those U.S. persons who own at least 10 percent of the stock (measured by vote only).[754] Such 10-percent owners

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[749] A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs under section 911. For a description of this exclusion, see *Present Law and Issues in U.S. Taxation of Cross-Border Income* (JCX-42-11), September 6, 2011, p. 52.

[750] Secs. 951-964.

[751] Secs. 1291-1298.

[752] Secs. 901, 902, 960, 1293(f).

[753] Secs. 951-964.

[754] Secs. 951(b), 957, 958. The term "United States shareholder" is used interchangeably herein with "U.S. shareholder."

Subpart F income

Under the subpart F rules, the United States generally taxes the 10-percent U.S. shareholders of a CFC on their pro rata shares of certain income of the CFC (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders.[755] In effect, the United States treats the 10-percent U.S. shareholders of a CFC as having received a current distribution of the corporation's subpart F income. With exceptions described below, subpart F income generally includes passive income and other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,[756] insurance income,[757] and certain income relating to international boycotts and other violations of public policy.[758]

Foreign base company income consists of foreign personal holding company income, which includes passive income such as dividends, interest, rents, and royalties, and a number of categories of income from business operations, including foreign base company sales income, foreign base company services income, and foreign base company oil-related income.[759]

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Finally, special rules apply under subpart F with respect to related person insurance income[760] in order to address captive insurance companies.[761] Under these rules, the threshold for determining control is reduced to 25-percent, and any level of stock ownership by a U.S. person in such corporation is sufficient to be treated as a U.S. shareholder.

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[755] Sec. 951(a).

[756] Sec. 954.

[757] Sec. 953.

[758] Sec. 952(a)(3)-(5).

[759] Sec. 954.

[760] Sec. 953(c). Related person insurance income is defined for this purpose to mean any insurance income attributable to a policy of insurance or reinsurance with respect to which the primary insured is either a U.S. shareholder (within the meaning of the provision) in the foreign corporation receiving the income or a person related to such a shareholder.

[761] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987, p. 968.

Investments in U.S. property

The 10-percent U.S. shareholders of a CFC also are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's untaxed earnings invested in certain items of U.S. property.[762] This U.S. property generally includes tangible property located in the United States, stock of a U.S. corporation, an obligation of a U.S. person, and certain intangible assets, such as patents and copyrights, acquired or developed by the CFC for use in the United States.[763] There are specific exceptions to the general definition of U.S. property, including for bank deposits, certain export property, and certain trade or business obligations.[764] The inclusion rule for investment of earnings in U.S. property is intended to prevent taxpayers from avoiding U.S. tax on dividend repatriations by repatriating CFC earnings through non-dividend payments, such as loans to U.S. persons.

Subpart F exceptions

Several exceptions to the broad definition of subpart F income permit continued deferral for certain transactions, dividends, interest and certain rents and royalties received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized.[765] The same-country exception is not available to the extent that the payments reduce the subpart F income of the payor. A second exception from foreign base company income and insurance income is available for any item of income received by a CFC if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90 percent of the maximum U.S. corporate income tax rate (that is, more than 90 percent of 35 percent, or 31.5 percent).[766]

A provision colloquially referred to as the "CFC look-through" rule excludes from foreign personal holding company income dividends, interest, rents, and royalties received or accrued by one CFC from a related CFC (with relation based on control) to the extent attributable or properly allocable to non-subpart-F income of the payor.[767] The look-through rule applies to taxable years of foreign corporations beginning before January 1, 2020, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.[768]

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[762] Secs. 951(a)(1)(B), 956.

[763] Sec. 956(c)(1).

[764] Sec. 956(c)(2).

[765] Sec. 954(c)(3).

[766] Sec. 954(b)(4).

[767] Sec. 954(c)(6).

[768] See section 144 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Pub. L. No. 114-113), H.R. 2029 ["the PATH Act of 2015"], which extended section 954(c)(6) for five years. Congress has previously extended the application of section 954(c)(6) several times, most recently in the Tax Increase Prevention

There is also an exclusion from subpart F income for certain income of a CFC that is derived in the active conduct of banking or financing business ("active financing income"), which applies to all taxable years of the foreign corporation beginning after December 31, 2014, and for taxable years of the shareholders that end during or within such taxable years of the corporation.[769] With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met.

In the case of a securities dealer, an exception from foreign personal holding company income applies to any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

Income is treated as active financing income only if, among other requirements, it is derived by a CFC or by a QBU of that CFC. Certain activities conducted by persons related to the CFC or its QBU are treated as conducted directly by the CFC or qualified business unit.[770] An activity qualifies under this rule if the activity is performed by employees of the related person and if the related person is an eligible CFC, the home country of which is the same as the home country of the related CFC or QBU; the activity is performed in the home country of the related person; and the related person receives arm's-length compensation that is treated as earned in the home country. Income from an activity qualifying under this rule is excluded from subpart F income so long as the other active financing requirements are satisfied.

Certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch or within the CFC's country of creation or

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Act of 2014, Pub. L. No. 113-295; Pub. L. No. 107-147, sec. 614, 2002; Pub. L. No. 106-170, sec. 503, 1999; Pub. L. No. 105-277, 1998.

[769] Sec. 954(h). See section 128 of the PATH Act of 2015, which made the active financing exception permanent.

[770] Sec. 954(h)(3)(E).

organization are also excepted from foreign personal holding company income, provided that certain requirements are met. Further, additional exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions, including reserve requirements, are met.[771]

Exclusion of previously taxed earnings and profits

A 10-percent U.S. shareholder of a CFC may exclude from its income actual distributions of earnings and profits from the CFC that were previously included in the 10-percent U.S. shareholder's income under subpart F.[772] Any income inclusion (under section 956) resulting from investments in U.S. property may also be excluded from the 10-percent U.S. shareholder's income when such earnings are ultimately distributed.[773] Ordering rules provide that distributions from a CFC are treated as coming first out of earnings and profits of the CFC that have been previously taxed under subpart F, then out of other earnings and profits.[774]

Basis adjustments

In general, a 10-percent U.S. shareholder of a CFC receives a basis increase with respect to its stock in the CFC equal to the amount of the CFC's earnings that are included in the 10-percent U.S. shareholder's income under subpart F.[775] Similarly, a 10-percent U.S. shareholder of a CFC generally reduces its basis in the CFC's stock in an amount equal to any distributions that the 10-percent U.S. shareholder receives from the CFC that are excluded from its income as previously taxed under subpart F.[776]

Passive foreign investment companies

The Tax Reform Act of 1986[777] established the PFIC anti-deferral regime. A PFIC is generally defined as any foreign corporation if 75 percent or more of its gross income for the

[771] Subject to approval by the IRS, a taxpayer may establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

[772] Sec. 959(a)(1).

[773] Sec. 959(a)(2).

[774] Sec. 959(c).

[775] Sec. 961(a).

[776] Sec. 961(b).

[777] Pub. L. No. 99-514.

taxable year consists of passive income, or 50 percent or more of its assets consists of assets that produce, or are held for the production of, passive income.[778] Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a PFIC, regardless of their percentage ownership in the company. One set of rules applies to PFICs that are qualified electing funds, under which electing U.S. shareholders currently include in gross income their respective shares of the company's earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.[779] A second set of rules applies to PFICs that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of deferral.[780] A third set of rules applies to PFIC stock that is marketable, under which electing U.S. shareholders currently take into account as income (or loss) the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."[781]

Under the PFIC regime, passive income is any income which is of a kind that would be foreign personal holding company income, including dividends, interest, royalties, rents, and certain gains on the sale or exchange of property, commodities, or foreign currency. However, among other exceptions, passive income does not include any income derived in the active conduct of an insurance business by a corporation that is predominantly engaged in an insurance business and that would be subject to tax under subchapter L if it were a domestic corporation.[782] In applying the insurance exception, the IRS analyzes whether risks assumed under contracts issued by a foreign company organized as an insurer are truly insurance risks, whether the risks are limited under the terms of the contracts, and the status of the company as an insurance company.[783]

Other anti-deferral rules

The subpart F and PFIC rules are not the only anti-deferral regimes. Other rules that impose current U.S. taxation on income earned through corporations include the accumulated earnings tax rules[784] and the personal holding company rules.

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[778] Sec. 1297.

[779] Secs. 1293-1295.

[780] Sec. 1291.

[781] Sec. 1296.

[782] Sec. 1297(b)(2)(B).

[783] Notice 2003-34, 2003-C.B. 1 990, June 9, 2003. See also, Prop. Treas. Reg. sec. 1.1297-4, 26 CFR Part 1, REG-108214-15, April 24, 2015.

[784] Secs. 531-537.

Rules for coordination among the anti-deferral regimes are provided to prevent U.S. persons from being subject to U.S. tax on the same item of income under multiple regimes. For example, a corporation generally is not treated as a PFIC with respect to a particular shareholder if the corporation is also a CFC and the shareholder is a 10-percent U.S. shareholder. Thus, subpart F is allowed to trump the PFIC rules.

3. Foreign tax credit

Subject to certain limitations, U.S. citizens, resident individuals, and domestic corporations are allowed to claim credit for foreign income taxes they pay. A domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation is allowed a "deemed-paid" credit for foreign income taxes paid by the foreign corporation that the domestic corporation is deemed to have paid when the related income is distributed as a dividend or is included in the domestic corporation's income under the anti-deferral rules.[785]

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign-source taxable income (as determined under U.S. tax accounting principles). This limit is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[786] The limit is computed by multiplying a taxpayer's total U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year. If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may carry back the excess foreign taxes to the previous year or carry forward the excess taxes to one of the succeeding 10 years.[787]

The computation of the foreign tax credit limitation requires a taxpayer to determine the amount of its taxable income from foreign sources in each limitation category (described below) by allocating and apportioning deductions between U.S.-source gross income, on the one hand, and foreign-source gross income in each limitation category, on the other. In general, deductions are allocated and apportioned to the gross income to which the deductions factually relate.[788] However, subject to certain exceptions, deductions for interest expense and research and experimental expenses are apportioned based on taxpayer ratios.[789] In the case of interest expense, this ratio is the ratio of the corporation's foreign or domestic (as applicable) assets to its worldwide assets. In the case of research and experimental expenses, the apportionment ratio is based on either sales or gross income. All members of an affiliated group of corporations

[785] Secs. 901, 902, 960, 1291(g).

[786] Secs. 901, 904.

[787] Sec. 904(c).

[788] Treas. Reg. sec. 1.861-8(b), Temp. Treas. Reg. sec. 1.861-8T(c).

[789] Temp. Treas. Reg. sec. 1.861-9T, Treas. Reg. sec. 1.861-17.

generally are treated as a single corporation for purposes of determining the apportionment ratios.[790]

The term "affiliated group" is determined generally by reference to the rules for determining whether corporations are eligible to file consolidated returns.[791] These rules exclude foreign corporations from an affiliated group.[792] AJCA modified the interest expense allocation rules for taxable years beginning after December 31, 2008.[793] The effective date of the modified rules has been delayed to January 1, 2021.[794] The new rules permit a U.S. affiliated group to apportion the interest expense of the members of the U.S. affiliated group on a worldwide-group basis (that is, as if all domestic and foreign affiliates are a single corporation). A result of this rule is that interest expense of foreign members of a U.S. affiliated group is taken into account in determining whether a portion of the interest expense of the domestic members of the group must be allocated to foreign-source income. An allocation to foreign-source income generally is required only if, in broad terms, the domestic members of the group are more highly leveraged than is the entire worldwide group. The new rules are generally expected to reduce the amount of the U.S. group's interest expense that is allocated to foreign-source income.

The foreign tax credit limitation is applied separately to passive category income and to general category income.[795] Passive category income includes passive income, such as portfolio interest and dividend income, and certain specified types of income. General category income includes all other income. Passive income is treated as general category income if it is earned by a qualifying financial services entity. Passive income is also treated as general category income if it is highly taxed (that is, if the foreign tax rate is determined to exceed the highest rate of tax specified in Code section 1 or 11, as applicable). Dividends (and subpart F inclusions), interest, rents, and royalties received by a 10-percent U.S. shareholder from a CFC are assigned to a separate limitation category by reference to the category of income out of which the dividends or

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[790] Sec. 864(e)(1), (6); Temp. Treas. Reg. sec. 1.861-14T(e)(2).

[791] Secs. 864(e)(5), 1504.

[792] Sec. 1504(b)(3).

[793] AJCA sec. 401.

[794] Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, sec. 551(a).

[795] Sec. 904(d). AJCA generally reduced the number of income categories from nine to two, effective for tax years beginning in 2006. Before AJCA, the foreign tax credit limitation was applied separately to the following categories of income: (1) passive income, (2) high withholding tax interest, (3) financial services income, (4) shipping income, (5) certain dividends received from noncontrolled section 902 foreign corporations (also known as "10/50 companies"), (6) certain dividends from a domestic international sales corporation or former domestic international sales corporation, (7) taxable income attributable to certain foreign trade income, (8) certain distributions from a foreign sales corporation or former foreign sales corporation, and (9) any other income not described in items (1) through (8) (so-called "general basket" income). A number of other provisions of the Code, including several enacted in 2010 as part of Pub. L. No. 111-226, create additional separate categories in specific circumstances or limit the availability of the foreign tax credit in other ways. See, *e.g.*, secs. 865(h), 901(j), 904(d)(6), 904(h)(10).

other payments were made.[796] Dividends received by a 10-percent corporate shareholder of a foreign corporation that is not a CFC are also categorized on a look-through basis.[797]

Special rules apply to the allocation of income and losses from foreign and U.S. sources within each category of income.[798] Foreign losses of one category will first be used to offset income from foreign sources of other categories. If there remains an overall foreign loss, it will be deducted against income from U.S. sources. The same principle applies to losses from U.S. sources. In subsequent years, the losses that were deducted against another category or source of income will be recaptured. That is, an equal amount of income from same the category or source that generated a loss in the prior year will be recharacterized as income from the other category or source against which the loss was deducted. Up to 50 percent of income from one source in any subsequent year will be recharacterized as income from the other source, whereas foreign-source income in a particular category can be fully recharacterized as income in another category until the losses from prior years are fully recaptured.[799]

In addition to the foreign tax credit limitation just described, a taxpayer's ability to claim a foreign tax credit may be further limited by a matching rule that prevents the separation of creditable foreign taxes from the associated foreign income. Under this rule, a foreign tax generally is not taken into account for U.S. tax purposes, and thus no foreign tax credit is available with respect to that foreign tax, until the taxable year in which the related income is taken into account for U.S. tax purposes.[800]

4. Special rules

Dual consolidated loss rules

Under the rules applicable to corporations filing consolidated returns, a dual consolidated loss ("DCL") is any net operating loss of a domestic corporation if the corporation is subject to an income tax of a foreign country without regard to whether such income is from sources in or outside of such foreign country, or if the corporation is subject to such a tax on a residence basis (a "dual resident corporation").[801] A DCL generally cannot be used to reduce the taxable income of any member of the corporation's affiliated group. Losses of a separate unit of a domestic corporation (a foreign branch or an interest in a hybrid entity owned by the corporation) are subject to this limitation in the same manner as if the unit were a wholly owned subsidiary of

[796] Sec. 904(d)(3). The subpart F rules applicable to CFCs and their 10-percent U.S. shareholders are described below.

[797] Sec. 904(d)(4).

[798] Secs. 904(f), (g).

[799] Secs. 904(f)(1), (g)(1).

[800] Sec. 909.

[801] Sec. 1503(d).

such corporation. An exemption is available under Treasury regulations in the case of DCLs for which a domestic use election (that is, an election to use the loss only for domestic, and not foreign, tax purposes) has been made.[802] Recapture is required, however, upon the occurrence of certain triggering events, including the conversion of a separate unit to a foreign corporation and the transfer of 50 percent or more of the assets of a separate unit within a twelve-month period.[803]

Temporary dividends-received deduction for repatriated foreign earnings

AJCA section 421 added to the Code section 965, a temporary provision intended to encourage U.S. multinational companies to repatriate foreign earnings. Under section 965, for one taxable year certain dividends received by a U.S. corporation from its CFCs were eligible for an 85-percent dividends-received deduction. At the taxpayer's election, this deduction was available for dividends received either during the taxpayer's first taxable year beginning on or after October 22, 2004, or during the taxpayer's last taxable year beginning before such date.

The temporary deduction was subject to a number of general limitations. First, it applied only to cash repatriations generally in excess of the taxpayer's average repatriation level calculated for a three-year base period preceding the year of the deduction. Second, the amount of dividends eligible for the deduction was generally limited to the amount of earnings shown as permanently invested outside the United States on the taxpayer's recent audited financial statements. Third, to qualify for the deduction, dividends were required to be invested in the United States according to a domestic reinvestment plan approved by the taxpayer's senior management and board of directors.[804]

No foreign tax credit (or deduction) was allowed for foreign taxes attributable to the deductible portion of any dividend.[805] For this purpose, the taxpayer was permitted to specifically identify which dividends were treated as carrying the deduction and which dividends were not. In other words, the taxpayer was allowed to choose which of its dividends were treated as meeting the base-period repatriation level (and thus carry foreign tax credits, to the extent otherwise allowable), and which of its dividends were treated as part of the excess eligible for the deduction (and thus subject to proportional disallowance of any associated foreign tax

[802] Treas. Reg. sec. 1.1503(d)-6(d).

[803] See Treas. Reg. sec. 1.1503(d)-6(e)(1).

[804] Section 965(b)(4). The plan was required to provide for the reinvestment of the repatriated dividends in the United States, including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, and the financial stabilization of the corporation for the purposes of job retention or creation.

[805] Sec. 965(d)(1).

credits).[806] Deductions were disallowed for expenses that were directly allocable to the deductible portion of any dividend.[807]

Domestic international sales corporations

A domestic international sales corporation ("DISC") is a domestic corporation that satisfies the following conditions: 95 percent of its gross receipts must be qualified export receipts; 95 percent of the sum of the adjusted bases of all its assets must be attributable to the sum of the adjusted bases of qualified export assets;[808] the corporation must have no more than one class of stock; the par or stated value of the outstanding stock must be at least $2,500 on each day of the taxable year; and an election must be in effect to be taxed as a DISC.[809] In general, a DISC is not subject to corporate-level tax and offers limited deferral of tax liability to its shareholders.[810] DISC income attributable to a maximum of $10 million annually of qualified export receipts is generally exempt from corporate and shareholder level income tax. Shareholders must pay interest to account for the benefit of deferring the tax liability on undistributed DISC income related to this $10 million maximum annual amount.[811] Shareholders of a DISC are deemed to receive a dividend out of current earnings and profits of qualified export receipts in excess of $10 million.[812] Gain on the sale of DISC stock is treated as a dividend to the extent of accumulated DISC income.[813] The shareholders of a corporation which is not a DISC, but was a DISC in a previous taxable year, and which has previously taxed income or accumulated DISC income, are also required to pay interest on the deferral benefit, and gain on the sale or exchange of stock in such corporation is treated as a dividend.

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[806] Accordingly, taxpayers generally were expected to pay regular dividends out of high-taxed CFC earnings (thereby generating deemed-paid credits available to offset foreign-source income) and section 965 dividends out of low-taxed CFC earnings (thereby availing themselves of the 85-percent deduction).

[807] Sec. 965(d)(2).

[808] If a corporation fails to satisfy either or both of the 95-percent tests, it is deemed to satisfy such tests if it makes a pro rata distribution of its gross receipts which are not qualified export receipts and the fair market value of its assets which are not qualified export assets. Sec. 992(c).

[809] Secs. 992(a) and (b).

[810] Sec. 991.

[811] The rate is the average of 1-year constant maturity Treasury yields. The deferral benefit is the excess of the amount of tax the shareholder would be liable if deferred DISC income were included as ordinary income over the actual tax liability of such shareholder. Sec. 995(f).

[812] The amount of the deemed distribution is the sum of several items, including qualified export receipts in excess of $10 million. See sec. 955(b).

[813] Sec. 995(c).

II. TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

A. Establishment of Participation Exemption System for Taxation of Foreign Income

1. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations

Description of Proposal

In general

The proposal generally establishes a participation exemption system for foreign income. This exemption is provided for by means of a 100-percent deduction (referred to here as "participation DRD") for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b).[814]

A specified 10-percent owned foreign corporation is any foreign corporation with respect to which any domestic corporation is a United States shareholder. The term does not include a PFIC that is not also a CFC.[815]

The phrase "dividend received" is intended to be interpreted broadly, consistently with the meaning of the phrases "amount received as dividends" and "dividends received" under sections 243 and 245, respectively.[816] Under proposed section 245A(e), the Secretary of the Treasury may prescribe such regulations or other guidance as may be necessary or appropriate to carry out the rules of section 245A, including clarifying the broad intended scope of the term "dividend received."

For example, if a domestic corporation indirectly owns stock of a foreign corporation through a foreign partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the dividend of the foreign partnership from the foreign corporation.

[814] Under section 951(b), a domestic corporation is a United States shareholder of a foreign corporation if it owns, within the meaning of section 958(a), or is considered as owning by applying the rules of section 958(b), 10 percent or more of the voting stock of the foreign corporation.

[815] Secs. 1297 and 1298.

[816] Consequently, for example, gain included in gross income as a dividend under section 1248(a) or 964(e) would constitute a dividend received for which the deduction under section 245A may be available.

Foreign-source portion of a dividend

The participation DRD is available only for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the specified foreign corporation's post-1986 undistributed foreign earnings bears to the corporation's total post-1986 undistributed earnings. Post-1986 undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation accumulated in taxable years beginning after December 31, 1986, as of the close of the taxable year of the foreign corporation in which the dividend is distributed and not reduced by dividends[817] distributed during that year. Post-1986 undistributed foreign earnings are, in general, the portion of post-1986 undistributed earnings that is not attributable to post-1986 undistributed U.S. earnings. Post-1986 undistributed U.S. earnings are, in general, undistributed earnings attributable to: (a) the corporation's income that is effectively connected with the conduct of a trade or business within the United States, or (b) any dividend received (directly or through a wholly owned foreign corporation) from an 80-percent-owned (by vote or value) domestic corporation.

Rules similar to the rules described above apply when a dividend is paid out of earnings and profits of a specified 10-percent owned foreign corporation accumulated in taxable years beginning before January 1, 1987. As a consequence, the participation exemption system is available for both post-1986 and pre-1987 foreign earnings. An ordering rule provides that dividends are treated as first being paid out of post-1986 undistributed earnings to the extent of those earnings.

An additional rule provides for the treatment of distributions of a specified 10-percent owned foreign corporation in excess of undistributed earnings. Under section 316(a)(2), a distribution of earnings and profits of a corporation in the taxable year of the distribution is treated as a dividend even if the distribution exceeds accumulated earnings and profits.[818] The determination of the foreign-source portion of such a distribution is calculated in a similar manner as for other types of dividends.

Foreign tax credit disallowance; foreign tax credit limitation

No foreign tax credit or deduction is allowed for any taxes (including withholding taxes) paid or accrued with respect to a dividend that qualifies for the participation DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a United States shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income (and entire taxable income) by disregarding the foreign-source portion of any dividend received from that foreign corporation

[817] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

[818] Called a "nimble dividend." *See*, Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders*, (7th ed. 2016) para. 8-12.

for which the participation DRD is taken, as well as and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Six-month holding period requirement

A domestic corporation is not permitted a participation DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 180 days or less during the 361-day period beginning on the date that is 180 days before the date on which the share becomes ex-dividend with respect to the dividend. For this purpose, a domestic corporation is treated as holding a share of stock for any period only if the corporation is a specified 10-percent owned foreign corporation and the taxpayer is a United States shareholder with respect to such corporation during that period.

The participation DRD is permitted in respect of any dividend on any share of stock to the extent the domestic corporation that owns the share is under an obligation (under a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. There are also other holding period requirements, such as the rule requiring holding periods to be reduced, in a manner provided for by regulations provided for by the Secretary of the Treasury, for any period during which the taxpayer has diminished its risk of loss in respect of stock on which a dividend is paid.

Effective Date

The proposal applies to distributions made (and, for purposes of determining a taxpayer's foreign tax credit limitation under section 904, deductions with respect to taxable years ending) after December 31, 2017.

2. Application of participation exemption to investments in United States property

Description of Proposal

Under the proposal, the amount determined under section 956 (relating to CFC investments in United States property) with respect to a domestic corporation is zero. A similar rule is intended for domestic corporations that own a CFC through a domestic partnership. The proposal includes a specific grant of authority to the Secretary to issue regulations to effect that intent.

Effective Date

The proposal applies to taxable years of foreign corporations beginning after December 31, 2017.

3. Limitation on losses with respect to specified 10-percent owned foreign corporations

Description of Proposal

Reduction in basis of certain foreign stock

Under the proposal, solely for the purpose of determining a loss, a domestic corporate shareholder's adjusted basis in the stock of a specified 10-percent owned foreign corporation (as defined in new section 245A) is reduced, but not below zero, by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a dividends received deduction allowable under section 245A in any taxable year of such domestic corporation. This rule applies in coordination with section 1059, such that any reduction in basis required pursuant to this proposal will be disregarded, to the extent the basis in the 10-percent owned foreign corporation's stock has already been reduced pursuant to section 1059.

Inclusion of transferred loss amount in certain assets transfers

Under the proposal, if a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of section 367(a)(3)(C)) to a foreign corporation which, after such transfer, is a specified 10-percent owned foreign corporation with respect to which the domestic corporation is a United States shareholder, the domestic corporation includes in gross income an amount equal to the transferred loss amount, subject to certain limitations.

The transferred loss amount is the excess of: (1) losses incurred by the foreign branch after December 31, 2017 for which a deduction was allowed to the domestic corporation, over (2) the sum of taxable income earned by the foreign branch and gain recognized by reason of an overall foreign loss recapture arising out of disposition of assets on account of the underlying transfer. For the purposes of (2), only taxable income of the foreign branch in taxable years after the loss is incurred through the close of the taxable year of the transfer is included.

For transfers not covered by section 367(a)(3)(C), the transferred loss amount is reduced by the amount of gain recognized by the domestic corporation on the transfer (other than gains recognized by reason of overall foreign loss recapture). For transfers covered by section 367(a)(3)(C), the transferred loss amount is reduced by the amount of gain recognized by reason of such subparagraph.

Amounts included in gross income by reason of the proposal or by reason of section 367(a)(3)(C) are treated as derived from sources within the United States.

The proposal provides authority for the Secretary of the Treasury to prescribe regulations or other guidance for proper adjustments to the adjusted basis of the specified 10-percent owned foreign corporation to which the transfer is made, and to the adjusted basis of the property transferred, to reflect amounts included in gross income under the proposal.

Effective Date

The proposal relating to reduction of basis in certain foreign stock for purposes of determining a loss is effective for distributions made after December 31, 2017.

The proposal relating to transfers of loss amounts from foreign branches to certain foreign corporations is effective for transfers after December 31, 2017.

4. Treatment of deferred foreign income upon transition to participation exemption system of taxation

Description of Proposal

In general

The proposal generally requires that, for the last taxable year beginning before January 1, 2018, all U.S. shareholders of any CFC or other foreign corporation that is at least 10-percent U.S.-owned but not controlled (other than a PFIC) must include in income their pro rata share of the accumulated post-1986 deferred foreign income and which was not previously taxed. A portion of that pro rata share of deferred foreign income is deductible; the amount deductible varies depending upon whether the deferred foreign income is held in the form of liquid or illiquid assets. The deduction results in a reduced rate of tax applicable to the included deferred foreign income. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The increased tax liability generally may be paid over an eight-year period.

Subpart F inclusion of deferred foreign income

The mechanism for the mandatory inclusion of pre-effective date foreign earnings is subpart F. The proposal provides that the subpart F income of all specified foreign corporations is increased for the last taxable year[819] that begins before January 1, 2018, by its accumulated post-1986 deferred foreign income. In contrast to the participation exemption deduction available only to domestic corporations that are U.S. shareholders under subpart F, the transition rule applies to all U.S. shareholders[820] of a specified foreign corporation. A specified foreign corporation means (1) a CFC or (2) any foreign corporation in which a domestic corporation is a U.S. shareholder (determined without regard to the special attribution rules of section 958(b)(4)), other than a PFIC that is not a CFC.[821] A specified foreign corporation that has deferred foreign income is a deferred foreign income corporation. Consistent with the general operation of

[819] Foreign corporations no longer in existence and for which there is no taxable year beginning or ending in 2017 are not within the scope of this provision.

[820] Sec. 951(b), which defines United States shareholder as any U.S. person that owns 10 percent or more of the voting classes of stock of a foreign corporation.

[821] Taxation of income earned by PFICs remains subject to the antideferral PFIC regime and are ineligible for the dividend received deduction under new section 245A.

subpart F, each U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the foreign corporation's subpart F income attributable to its accumulated deferred foreign income.[822]

Accumulated post-1986 deferred foreign income

Accumulated post-1986 deferred foreign income of a specified foreign corporation that is the subject of the mandatory inclusion under this proposal is the greater of the accumulated post-1986 deferred foreign income determined as of November 2, 2017 (the date of introduction of the bill) or as of December 31, 2017. The includible portion of the accumulated post-1986 deferred foreign income is all post- 1986 earnings and profits ("E&P") that are (1) not attributable to income that is effectively connected with the conduct of a trade or business in the United States and thus subject to current U.S. income tax, or (2) when distributed, not excludible from the gross income of a U.S. shareholder as previously taxed income under section 959.

Post-1986 earnings and profits are those earnings that accumulated in taxable years beginning after 1986, computed in in accordance with sections 964(a) and 986, even if arising from periods during which the U.S. shareholder did not own stock of the foreign corporation. Post-1986 earnings are not reduced by distributions during the taxable year to which section 965 applies. Such earnings are increased by the amount of qualified deficits[823] that arose in a taxable year beginning before January 1, 2018, if such deficit is also treated as a qualified deficit for purposes of taxable years beginning after December 31, 2017. Finally, the post-1986 earnings and profits are determined by reference to the foreign corporation's total earnings and profits, irrespective of the foreign tax credit separate category limitations.

The Secretary may prescribe appropriate rules regarding the treatment of accumulated post-1986 foreign deferred income of specified foreign corporations that have shareholders who are not U.S. shareholders. Such rules may also include rules that are appropriate to implement the intent of the revised section 965 and the use of the date of introduction as one of the measurement dates in order to establish a floor for determining the post-1986 deferred foreign earnings and profits. For example, guidance may address the extent to which retroactive effective dates selected in entity classification elections filed after introduction of the bill will be permitted.[824]

Reductions of amounts included in income of U.S. shareholder of foreign corporations with deficits in E&P

The income inclusion required of a U.S. shareholder under this transition rule is reduced by the portion of aggregate foreign earnings and profits deficit allocated to that person by reason

[822] For purposes of taking into account its subpart F income under this rule, a noncontrolled 10/50 corporation is treated as a CFC.

[823] Sec. 952(c)(1)(B)(ii).

[824] See Treas, Reg, 301.7701-3(c), under which an election may specify an effective date up to 75 days prior to the date on which the election is filed.

of that person's interest in one or more E&P deficit foreign corporations. An E&P deficit foreign corporation is defined as any specified foreign corporation owned by the U.S. shareholder as of the date on which accumulated earnings and profits are measure for that corporation (November 2, 2017 or December 31, 2017, as the case may be) and which also has a deficit in post-1986 earnings and profits as of that date. Accordingly, the deficits of a foreign subsidiary that accumulated prior to its acquisition by the U.S. shareholder may be taken into account in determining the aggregate foreign earnings and profits deficit of a U.S. shareholder. [825]

The U.S. shareholder aggregates its pro rata share in the foreign E&P deficits of each such company and allocates such aggregate amount among the deferred foreign income corporations in which the shareholder is a U.S. shareholder. The aggregate foreign E & P deficit is allocable to a specified foreign corporation in the same ratio as the U.S. shareholder's pro rata share of post-1986 deferred income in that corporation bears to the U.S. shareholder's pro rata share of accumulated post-1986 deferred foreign income from all deferred income companies of such shareholder.

To illustrate the ratio, assume that Z, a domestic corporation, is a U.S. shareholder with respect to each of four specified foreign corporations, two of which are E&P deficit foreign corporations. Assume further the foreign companies have the following accumulated post-1986 deferred foreign income or foreign E&P deficits as of November 2, 2017 and December 31, 2017:

Example

Specified Foreign Corp.	Percentage Owned	Post-1986 profit/deficit USD	Pro Rata Share
A	60%	($1,000)	($600)
B	10%	($200)	($20)
C	70%	$2,000	$1,400
D	100%	$1,000	$1,000

The aggregate foreign E & P deficit of the U. S. shareholder is ($620), and the aggregate share of accumulated post-1986 deferred foreign income is $2,400. Thus, the portion of the aggregate foreign E&P deficit allocable to Corporation C is ($362), that is, ($620) x 1400/2400.

[825] For example, assume that a foreign corporation organized after December 31, 1986 has $100 of accumulated earnings and profits as of November 1, 2017, and December 31, 2017 (determined without diminution by reason of dividends distributed during the taxable year and after any increase for qualified deficits), which consist of $120 general limitation earnings and profits and a $20 passive limitation deficit, the foreign corporation's post-1986 earnings and profits would be $100, even if the $20 passive limitation deficit was a hovering deficit described in Treas. Reg. sec. 1.367(b)-17(d)(2). Foreign income taxes related to the hovering deficit, however, would not be deemed paid by the U.S. shareholder recognizing an incremental income inclusion.

The remainder of the aggregate foreign E&P deficit is allocable to Corporation D. The U.S. shareholder has a net surplus of E&P in the amount of $1,780.

The proposal also permits intragroup netting among U.S. shareholders in an affiliated group in which there is at least one U.S. shareholder with a net E&P surplus and another with a net E&P deficit. The net E&P surplus shareholder may reduce its net surplus by the shareholder's applicable share of aggregate unused E&P deficit, based on the group's ownership percentage of the members. For example, a U.S. corporation may have two domestic subsidiaries, X and Y, in which it owns 100 percent and 80 percent, respectively. If X has a $1,000 net E&P surplus, and Y has $1,000 net E&P deficit, X is an E&P net surplus shareholder, and Y is an E&P net deficit shareholder. The net E&P surplus of X may be reduced by the net E&P deficit of Y to the extent of the group's ownership percentage in Y, which is 80-percent. The remaining net E&P deficit of Y is unused. If the U.S. shareholder Z is also a wholly owned subsidiary of the same U.S. parent as X and Y, the group ownership percentage of Y is unchanged, and the surpluses of X and Z are reduced ratably by 800 of the net E&P deficit of Y.

Participation exemption applied to accumulated post-1986 deferred foreign income

A U.S. shareholder of a specified foreign corporation is allowed a deduction of a portion of the increased subpart F income attributable to the inclusion of pre-effective date deferred foreign income. The amount of the deduction is the sum of the 12-percent rate equivalent percentage of the inclusion amount that is the shareholder's aggregate cash position and the 5-percent rate equivalent percentage of the portion of the inclusion that exceeds the aggregate cash position. By stating the permitted deduction in the form of a tax rate equivalent percentage, the proposal ensures that all pre-effective date accumulated post-1986 deferred foreign income is subject to either a 5-percent or 12-percent rate of tax, depending on the underlying assets as of the measurement date, without regard to the corporate tax rate that may be in effect at the time of the inclusion. For example, corporate taxpayers that use a fiscal year as the taxable year may report the increased subpart F income in a taxable year for which a reduced corporate tax rate would otherwise apply (on a pro-rated basis under section 15), but the allowable deduction would be reduced such that the rate of U.S. tax on the income inclusion would be 5 or 12 percent.

Aggregate cash position

The aggregate cash position of a U.S. shareholder is the average of the sum of the shareholder's pro rata share of the cash position of each specified foreign corporation with respect to which that shareholder is a U.S. shareholder on each of three dates: Date of introduction (November 2, 2017) and the last day of the two most recent taxable years ending before the date of introduction. Appropriate adjustments are made if a specified foreign corporation is not in existence on one or more of those dates. By using a three-year average as the aggregate cash position for a U.S. shareholders, the effect of unusual or anomalous transactions is muted.

For purposes of this computation, the cash position of certain non-corporate entities that would be treated as specified foreign corporations if they were foreign corporations is also included. The cash position of an entity consists of all cash, net accounts receivables, and the

fair market value of similarly liquid assets, specifically including personal property that is actively traded on an established financial market, government securities, certificates of deposit, commercial paper, foreign currency, and short-term obligations. In addition, the Secretary may identify other assets that are economically equivalent to the enumerated assets that are included.

Certain reductions from aggregate cash position are specified in the proposal. First, rules are provided to avoid the double counting of cash position of specified foreign corporations in an affiliated group, while ensuring that all of the cash position is taken into account. Second, regardless of the form in which a specified foreign corporation holds earnings, to the extent that the earnings constitute blocked income that could not be distributed by the corporation due to local jurisdiction restrictions,[826] such earnings are not included in the cash position of that specified foreign corporation. The blocked income remains within the scope of the accumulated post-1986 deferred foreign income that is subject to inclusion under this proposal.

In addition to the authority to identify other assets that are subject to the cash position determination by regulation, the proposal also authorizes the Secretary to disregard transactions that he determines had the principal purpose of reducing the aggregate foreign cash position.

Foreign tax credits reduced

The portion of foreign income taxes deemed paid or accrued with respect to the inclusion required by the proposal are not creditable against the Federal income tax attributable to the inclusion, nor are they deductible. The disallowed portion of foreign tax credits is 85.7-percent of foreign taxes paid attributable to the portion of the section 965 inclusion attributable to the aggregate cash position plus 65.7-percent of foreign taxes paid attributable to the remaining portion of the section 965 inclusion.[827] A U.S. shareholder is not required to gross-up income under section 78 to the extent of the taxes for which no foreign tax credit is allowed.

The amount of deferred foreign income required to be included in subpart F income under this proposal is disregarded for purposes of determining the amount of income from foreign sources and the combined foreign oil and gas income that a U.S. shareholder has for purposes of the recapture rules applicable to overall foreign losses, separate limitation losses, and foreign oil and gas losses under sections 904(f)(1) and 907(c)(4).

The foreign income taxes deemed paid with respect to the inclusion required by the proposal and for which no credit is allowed in the year of inclusion by reason of section 904 limitations (e.g., because part or all of the inclusion required by the proposal is offset by a net operating loss deduction) are eligible for a special 20 year carry forward period, rather than the otherwise available 10 year period.

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[826] Sec. 964(b) and regulations thereunder.

[827] Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full.

Installment payments

A U.S. shareholder may elect to pay the net tax liability resulting from the mandatory inclusion of pre-effective-date undistributed CFC earnings in eight equal installments. The net tax liability that may be paid in installments is the excess of the U.S. shareholder's net income tax for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income over the taxpayer's net income tax for that year determined without regard to the inclusion. Net income tax means net income tax as defined for purposes of the general business credit, but reduced by the amount of that credit.

An election to pay tax in installments must be made by the due date for the tax return for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income. The Treasury Secretary has authority to prescribe the manner of making the election. The first installment must be paid on the due date (determined without regard to extensions) for the tax return for the taxable year of the income inclusion. Succeeding installments must be paid annually no later than the due dates (without extensions) for the income tax return of each succeeding year. If a deficiency is later determined with respect to the net tax liability, the additional tax due may be prorated among all installment payments in most circumstances. The portions of the deficiency prorated to an installment that was due before the deficiency was assessed must be paid upon notice and demand. The portion prorated to any remaining installment is payable with the timely payment of that installment payment, unless the deficiency is attributable to negligence, intentional disregard of rules or regulations, or fraud with intent to evade tax, in which case the entire deficiency is payable upon notice and demand.

The timely payment of an installment does not incur interest. If a deficiency is determined that is attributable to an understatement of the net tax liability due under this proposal, the deficiency is payable with underpayment interest for the period beginning on the date on which the net tax liability would have been due, without regard to an election to pay in installments, and ending with the payment of the deficiency. Furthermore, any amount of deficiency prorated to a remaining installment also bears interest on the deficiency, but not on the original installment amount.

The proposal also includes an acceleration rule. If (1) there is a failure to pay timely any required installment, (2) there is a liquidation or sale of substantially all of the U.S. shareholder's assets (including in a bankruptcy case), (3) the U.S. shareholder ceases business, or (4) another similar circumstance arises, the unpaid portion of all remaining installments is due on the date of the event (or, in a title 11 or similar case, the day before the petition is filed).

Special rule for S corporations

A special rule permits deferral of the transition net tax liability for shareholders of a U.S. shareholder that is a flow-through entity known as an S corporation.[828] The S corporation is required to report on its income tax return the amount includible in gross income by reason of

[828] Section 1361 defines an S corporation as a domestic small business corporation that has an election in effect for status as an S corporation, with fewer than 100 shareholders, none of whom are nonresident aliens, and all of whom are individuals, estates, trusts or certain exempt organizations.

this proposal, as well as the amount of deduction that would be allowable, and provide a copy of such information to its shareholders. Any shareholder of the S corporation may elect to defer his portion of the net tax liability at transition to the participation exemption system until the shareholder's taxable year in which a triggering event occurs. The election to defer the tax is due not later than the due date for the return of the S corporation for its last taxable year that begins before January 1, 2018.

Three types of events may trigger an end to deferral of the net tax liability. The first type of triggering event is a change in the status of the corporation as an S corporation. The second category includes liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, including reorganization in bankruptcy. The third type of triggering event is a transfer of shares of stock in the S corporation by the electing taxpayer, whether by sale, death or otherwise, unless the transferee of the stock agrees with the Secretary to be liable for net tax liability in the same manner as the transferor. Partial transfers trigger the end of deferral only with respect to the portion of tax properly allocable to the portion of stock sold.

If a shareholder of an S corporation has elected deferral under the special rule for S corporation shareholders and a triggering event occurs, the S corporation and the electing shareholder are jointly and severally liable for any net tax liability and related interest or penalties. The period within which the IRS may collect such liability does not begin before the date of an event that triggers the end of the deferral. If an election to defer payment of the net tax liability is in effect for a shareholder, that shareholder must report the amount of the deferred net tax liability on each income tax return due during the period that the election is in effect. Failure to include that information with each income tax return will result in a penalty equal to five-percent of the amount that should have been reported.

After a triggering event occurs, a shareholder is the S corporation may elect to pay the net tax liability in eight equal installments, subject to rules similar to those generally applicable absent deferral. Whether a shareholder may elect to pay in installments depends upon the type of event that triggered the end of deferral. If the triggering event is a liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, the installment payment election is not available. Instead, the entire net tax liability is due upon notice and demand. The installment election is due with the timely return for the year in which the triggering event occurs. The first installment payment is required by the due date of the same return, determined without regard to extensions of time to file.

Effective Date

The proposal is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end.

B. Modifications Related to Foreign Tax Credit System

1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis

Description of Proposal

The proposal repeals the deemed-paid credit with respect to dividends received by a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation.

A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion. Foreign income taxes under the proposal include income, war profits, or excess profits taxes paid or accrued by the CFC to any foreign country or possession of the United States. The proposal eliminates the need for computing and tracking cumulative tax pools.

Additionally, the proposal provides rules applicable to foreign taxes attributable to distributions from previously taxed earnings and profits, including distributions made through tiered-CFCs.

The Secretary is granted authority under the proposal to provide regulations and other guidance as may be necessary and appropriate to carry out the purposes of this proposal. It is anticipated that the Secretary would provide regulations with rules for allocating taxes similar to rules in place for purposes of determining the allocation of taxes to specific foreign tax credit baskets.[829] Under such rules, taxes are not attributable to an item of subpart F income if the base upon which the tax was imposed does not include the item of subpart F income. For example, if foreign law exempts a certain type of income from its tax base, no deemed-paid credit results from the inclusion of such income as subpart F. Tax imposed on income that is not included in subpart F income, is not considered attributable to subpart F income.

In addition to the rules described in this section, the proposal makes several conforming amendments to various other sections of the Code reflecting the repeal of section 902 and the modification of section 960. These conforming amendments include amending the section 78 gross-up provision to apply solely to taxes deemed paid under the amended section 960.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[829] See Treas. Reg. sec. 1.904-6(a).

2. Source of income from sales of inventory determined solely on basis of production activities

Description of Proposal

Under this proposal, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States is allocated and apportioned on the basis of the location of production with respect to the property. For example, income derived from the sale of inventory property to a foreign jurisdiction is sourced wholly within the United States if the property was produced entirely in the United States, even if title passage occurred elsewhere. Likewise, income derived from inventory property sold in the United States, but produced entirely in another country, is sourced in that country even if title passage occurs in the United States. If the inventory property is produced partly in, and partly outside, the United States, however, the income derived from its sale is sourced partly in the United States.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

C. Modification of Subpart F Provisions

1. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment

Description of Proposal

The proposal repeals section 955. As a result, a U.S. shareholder in a CFC that invested its previously excluded subpart F income in qualified foreign base company shipping operations is no longer required to include in income a pro rata share of the previously excluded subpart F income when the CFC decreases such investments.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Repeal of treatment of foreign base company oil related income as subpart F income

Description of Proposal

The proposal eliminates foreign base company oil related income as a category of foreign base company income.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

3. Inflation adjustment of *de minimis* exception for foreign base company income

Description of Proposal

In the case of any taxable year beginning after 2017, the proposal indexes for inflation the $1,000,000 *de minimis* amount for foreign base company income, with all increases rounded to the nearest multiple of $50,000.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

4. Look-thru rule for related controlled foreign corporations made permanent

Description of Proposal

The proposal makes the exclusion from foreign personal holding company income for certain dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one controlled foreign corporation from a related controlled foreign corporation permanent.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2019, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

5. Modification of stock attribution rules for determining status as a controlled foreign corporation

Description of Proposal

The proposal amends the ownership attribution rules of section 958(b) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U. S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, the proposal provides "downward attribution" from a foreign person to a related U.S. person in circumstances in which present law does not so provide. The pro rata share of a CFC's subpart F income that a U.S. shareholder is required to include in gross income, however, continues to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

6. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply

Description of Proposal

The proposal eliminates the requirement that a corporation must be owned for an uninterrupted period of 30 days before subpart F inclusions apply.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

D. Prevention of Base Erosion

1. Current year inclusion by United States shareholders with foreign high returns

Description of Proposal

Under the proposal, a U.S. shareholder of any CFC must include in gross income for a taxable year an amount equal to 50 percent of its foreign high return amount ("FHRA") in a manner generally similar to inclusions of subpart F income. FHRA means, with respect to any U.S. shareholder for the shareholder's taxable year, the shareholder's net CFC tested income less an amount equal to the excess (if any) of (1) the applicable percentage of the aggregate of the shareholder's pro rata share of the qualified business asset investment ("QBAI") of each CFC with respect to which it is a U.S. shareholder over (2) the amount of interest expense taken into account in determining the shareholder's net CFC tested income. The applicable percentage is the Federal short-term rate (determined under section 1274(d) for the month in which such shareholder's taxable year ends) plus seven percentage points.

Net CFC tested income

Net CFC tested income means, with respect to any U.S. shareholder, the excess of the aggregate of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the tested loss of each CFC with respect to which it is a U.S. shareholder. Pro rata shares are determined under the rules of section 951(a)(2).

The tested income of a CFC means the excess (if any) of the gross income of the corporation determined without regard to: (1) the corporation's ECI if subject to tax; (2) any gross income taken into account in determining the corporation's subpart F income; (3) any amount, except as otherwise provided by the Secretary, that qualifies for CFC look-through treatment, but only to the extent that any deduction allowable for the payment or accrual of such amount does not result in a reduction of the FHRA of any U.S. shareholder (determine without regard to such amount); (4) any gross income excluded as foreign personal holding company income by reason of the exceptions for active financing income and active insurance income; (5) any gross income excluded from foreign base company income or insurance income by reason the high-tax exception under section 954(b)(4); (6) any dividend received from a related person (as defined in section 954(d)(3)); and (7) any commodities gross income, over deductions (including taxes) properly allocable to such gross income. Commodities gross income means the corporation's gross income from the disposition of commodities that it has produced or extracted and that are commodities described in sections 475(e)(2)(A) and 475(e)(2)(D).

The tested loss of a CFC means the excess (if any) of the deductions (including taxes) properly allocable to the corporation's gross income determined without regard to items (1) through (7) in the preceding paragraph, above, over the amount of such gross income.

Qualified business asset investment

QBAI means, with respect to any CFC for a taxable year, the aggregate of its adjusted bases (determined as of the close of the taxable year and after any adjustments with respect to

such taxable year) in specified tangible property used in its trade or business and with respect to which a deduction is allowable under section 168. Specified tangible property means any tangible property to the extent such property is used in the production of tested income or tested loss. The adjusted basis in any property is determined without regard to any provision of law which is enacted after the date of enactment of this proposal.

If a CFC holds an interest in a partnership as of the close of the corporation's taxable year, the corporation takes into account its distributive share of the aggregate of the partnership's adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by the partnership to the extent that such property is used in the trade or business of the partnership and is used in the production of tested income or tested loss (determined with respect to the corporation's distributive share of income or loss with respect to such property). The corporation's distributive share of the adjusted basis of any property is the corporation's distributive share of income and loss with respect to such property.

For purposes of determining QBAI, the Secretary is authorized to issue anti-avoidance regulations or other guidance as the Secretary determines appropriate, including regulations or other guidance that provide for the treatment of property if the property is transferred or held temporarily, or if avoidance was a factor in the transfer or holding of the property.

Foreign tax credits and coordination with subpart F

Deemed-paid credit for taxes properly attributable to tested income

For any FHRA included in the gross income of a domestic corporation, the corporation is deemed to have paid foreign income taxes equal to 80 percent of its foreign high return percentage multiplied by the aggregate tested foreign income taxes paid or accrued by each CFC with respect to which the corporation is a U.S. shareholder. The foreign high return percentage is the corporation's FHRA divided by the aggregate amount of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder. Tested foreign income taxes are the foreign income taxes paid or accrued by a CFC that are properly attributable to gross income taken into account in determining tested income or tested loss.

The proposal creates a separate foreign tax credit basket for FHRA, with no carryforward available for excess credits. The taxes deemed to have been paid are treated as an increase in FHRA for purposes of section 78, determined by taking into account 100 percent of the aggregate tested foreign income taxes.

Coordination with subpart F

With respect to any CFC any pro rata amount from which is taken into account in determining the FHRA included in gross income of a U.S. shareholder, such amount, except as otherwise provided by the Secretary, is treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962(c), 962(d), 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4).

The portion of the FHRA treated as being with respect to a CFC equals zero for a corporation with tested loss and, for a corporation with tested income, the portion of the FHRA which bears the same ratio to the FHRA as the shareholder's pro rata amount of tested income of such corporation bears to the aggregate amount of the shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder.

Tested losses taken into account in determining a U.S. shareholder's FHRA cannot also reduce the shareholder's inclusions in gross income under section 951(a)(1)(A) by reason of the earnings and profits limitation in section 952(c). Accordingly, a U.S. shareholder's amount included in gross income under section 951(a)(1)(A) with respect to a CFC is determined by increasing the earnings and profits of such corporation (solely for purposes of determining such amount) by an amount that bears the same ratio (not greater than 1) to the shareholder's pro rata share of the tested loss of such CFC as (1) the aggregate amount of the shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder bears to (2) the aggregate amount of the shareholder's tested loss of each CFC with respect to which it is a U.S. shareholder. If this increase in earnings and profits results in an incremental inclusion under section 951(a)(1)(A, the CFC will increases its earnings and profits described in section 959(c)(2) by that amount and decrease its earnings and profits in section 959(c)(3) by that amount (even if that results in, or increases, a deficit).

Taxable years for which persons are treated as U.S. shareholders of a CFC

For purposes of the FHRA inclusion, a U.S. shareholder of a CFC is treated as a U.S. shareholder of the corporation for any taxable year of the shareholder if a taxable year of the corporation ends in or with the taxable year of such person and the person owns (within the meaning of section 958(a)) stock in the corporation on the last day in the taxable year of the corporation on which the corporation is a CFC. A corporation is generally treated as a CFC for any taxable year if the corporation is a CFC at any time during the taxable year.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group

Description of Proposal

The proposal limits the amount of U.S. interest expense that a domestic corporation which is a member of an international financial reporting group can deduct to the sum of the member's interest income plus the allowable percentage of 110 percent of net interest expense. An international financial reporting group is a group that: (1) includes at least one foreign corporation engaged in a U.S. trade or business or at least one domestic corporation and one foreign corporation at any time during the group's reporting year, (2) prepares consolidated financial statements in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards ("IFRS"), or any other comparable

method identified by the Secretary,[830] and (3) reports in such statements average annual gross receipts in excess of $100,000,000 (determined in the aggregate with respect to all entities which are part of such group) for the three-reporting-year period ending with such reporting year.

The allowable percentage is the ratio of a corporation's allocable share of the international financial reporting group's net interest expense over such corporation's reported net interest expense. A corporation's allocable share of an international financial reporting group's net interest expense is determined based on the corporation's share of the group's earnings (computed by adding back net interest expense, taxes, depreciation, and amortization) as reflected in the group's consolidated financial statements. A corporation's reported net interest expense is its net interest expense reported in the books and records used to prepare the group's consolidated financial statements. For international financial reporting groups that do not prepare consolidated financial statements under U.S. GAAP, IFRS, or any other comparable method identified by the Secretary and which are filed with the United States Securities and Exchange Commission, the proposal provides a hierarchy of other audited consolidated financial statements that may be relied upon by such group.

The proposal applies to partnerships at the partnership level under rules similar to the rules of section 3301 of the bill. The proposal also applies to foreign corporations engaged in a U.S. trade or business. A U.S. consolidated group is considered a single corporation under this proposal.

The amount of any interest not allowed as a deduction for any taxable year by reason of this proposal or section 3301 of the bill (depending on whichever imposes the lower limitation with respect to such taxable year) can be carried forward as interest (and as business interest for purposes of section 3301 of the bill) for up to five years.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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830 The International Financial Reporting Standards are a set of accounting standards commonly used for the preparation of financial statements of public companies listed in countries outside the United States.

3. Excise tax on certain payments from domestic corporations to related foreign corporations; election to treat such payments as effectively connected income

Description of Proposal

In general

This proposal imposes an excise tax on certain amounts paid by U.S. payors to certain related foreign recipients to the extent the amounts are deductible by the U.S. payor. However, the excise tax does not apply if the foreign recipient elects to be subject to U.S. income tax on the amounts received. In calculating the U.S. income tax liability imposed under such an election, deemed expenses are allowed as a deduction. No foreign tax credits are allowed against the U.S. tax liability imposed by this proposal.

Excise tax

The proposal provides for an excise tax on specified amounts paid or incurred by a domestic corporation to a foreign corporation if both the foreign and domestic corporations are members of the same international financial reporting group. The amount of the tax is equal to 20 percent of the specified amounts paid or incurred. The excise tax is not imposed with respect to amounts that are or are deemed to be effectively connected with a U.S. trade or business of the foreign corporation.

A specified amount is any amount which is allowable by the payor as a deduction or includible in costs of goods sold, or inventory, or in the basis of an amortizable or depreciable asset. A specified amount does not include: (i) interest, (ii) an amount paid or incurred for the acquisition of a commodity defined in sections 475(e)(2)(A) or (d), that is, a commodity actively traded within the meaning of section 1092(d)(1) or an identified hedge of such commodity, or, (iii) for a payor which has elected to use a services cost method under section 482, an amount paid or incurred for services if such amount is the total services cost with no markup.

An international financial reporting group is any group of entities that prepares consolidated financial statements[831] if the average annual aggregate payment amount for the group for the three-year period ending in the reporting year exceeds $100,000,000. The annual aggregate payment amount means the aggregate of the specified amounts made by U.S. members of the group to foreign members of the group during the reporting year.

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[831] This term is defined in new section 163(n)(4) as a financial statement certified as being prepared in accordance with generally accepted accounting principles, international financial reporting standards, or any other comparable method of accounting identified by the Secretary of the Treasury and which is: (i) a 10-K (or successor form), or annual statement to shareholders required to be filed with the United States Securities and Exchange Commission, or, if this is not available, (ii) an audited financial statement used for (1) credit purposes, (2) reporting to shareholders, partners or other proprietors, or to beneficiaries, or (3) any other substantial nontax purpose, or, if (i) and (ii) are not available, (iii) filed with any other Federal or State agency for nontax purposes, or, if (i), (ii), or (iii) are not available, a financial statement used for a purpose described in (ii)(1), (2) and (3), or filed with any regulatory or governmental body, within or outside the United States, specified by the Secretary of the Treasury.

Partnerships and branches

For purposes of this proposal, a partnership is treated as an aggregate of its partners. Accordingly, a payment made to a partnership is treated as a payment to the partners, and a payment from a partnership is treated as a payment from the partners, in an amount equal to the partner's distributive share of the relevant item of income, gain, deduction, or loss.

For purposes of this proposal, U.S. branches are treated as separate entities for purposes of determining the treatment of payments between a branch and entities other than its owner and for purposes of deemed payments between a branch and its owner.

Election to treat payments as effectively connected income

If a specified amount is paid or incurred by a domestic corporation with respect to a foreign corporation and both the foreign and domestic corporations are members of the same international financial reporting group, the foreign corporation may elect to take into account all such specified amounts as if the foreign corporation were engaged in a U.S. trade or business and had a permanent establishment and as if the payment were effectively connected with that U.S. trade or business and were attributable to the permanent establishment. If the foreign corporation makes such election, the excise tax is not imposed. The election applies for the taxable year for which the election is made and all subsequent taxable years unless revoked with consent of the Secretary of the Treasury.

The deemed expenses with respect to any specified amount received by a foreign corporation during any reporting year is the amount of expenses such that the net income ratio of the foreign corporation with respect to the specified amount (taking into account only such deemed expenses) is equal to the net income ratio of the international financial reporting group determined for the reporting year with respect to the product line to which the specified amount relates. The net income ratio is the ratio of net income determined without regard to income taxes, interest income, and interest expense, divided by revenue. The net income ratio is calculated in accordance with the books and records used in preparing the group's consolidated financial statements.

In general, the amount treated as effectively connected income under this proposal is treated as such for all purposes of the Code. For example, it is subject to the branch profit tax and is not subject to the excise tax under section 4371. However, for purposes of section 245 and new section 245A, these amounts are not treated as effectively connected income. Therefore, a distribution of earnings attributable to the amounts described in this proposal is eligible for the participation DRD under new section 245A.

Coordination with FDAP

Amounts treated as effectively connected income under this proposal are not excluded from the definition of fixed or determinable annual or periodical ("FDAP") income. Payments subject to tax under section 881 do not constitute specified payments under this proposal except to the extent that the rate of tax imposed under section 881 is reduced by a bilateral income tax treaty.

Joint and several liability

If there is an underpayment with respect to any taxable year of an electing foreign corporation which is a member of an international financial accounting group, each domestic corporation in the group is jointly and severally liable for as much of the underpayment as does not exceed the excess of such underpayment over the amount of such underpayment determined without regard to this rule and any penalty, addition to tax, or additional amount attributable to the above amount.

Foreign tax credits and deductions

No credit or deduction is allowed for any taxes (including withholding taxes) paid or accrued with respect to any amount to which this proposal applies.

Reporting

An electing foreign corporation that receives a specified amount is required to report, with respect to each member of the international financial reporting group from which any such amount is received: (i) the name and taxpayer identification number of each member, (ii) the aggregate amounts received from each member, (iii) the product lines to which such amounts relate, the aggregate amounts relating to each product line, and the net income ratio for each product line, and (iv) a summary of changes in financial accounting methods that affect the computation of any net income ratio described above.

A domestic corporation that pays or accrues a specified amount with respect to which a foreign corporation has made the election is required to make a return according to the forms and regulations prescribed by the Secretary of the Treasury containing certain information and to maintain sufficient records to determine the tax liability imposed by this proposal. The information required to be provided is as follows: (1) the name and taxpayer identification number of the common parent of the international financial reporting group of which the domestic corporation is a member, and (2) with respect to a specified amount: (A) the name and taxpayer identification number of the recipient of the amount, (B) the aggregate amounts received by the recipient, (C) the product lines to which the amounts relate and the aggregate amounts for each product line, and the net income ratio for each product line, and (D) a summary of any changes in financial accounting methods that affect the computation of any net income ratio described in (C).

Effective Date

The proposal to amounts paid or incurred after December 31, 2018.

E. Provisions Related to Possessions of the United States

1. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico

Present Law

General

Present law generally provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[832] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[833] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[834] Wages paid to bona fide residents of Puerto Rico

[832] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[833] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

[834] For purposes of the proposal, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

generally are not included in the definition of wages for purposes of computing the wage limitation amount.[835]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[836] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.[837] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[838]

The special rules for Puerto Rico apply only with respect to the first 11 taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2017.

Description of Proposal

The proposal extends the special domestic production activities rules for Puerto Rico to apply for the first 12 taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2018.

Effective Date

The proposal applies to taxable years beginning after December 31, 2016.

2. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands

Present Law

A \$13.50 per proof gallon[839] excise tax is imposed on distilled spirits produced in or imported into the United States.[840] The excise tax does not apply to distilled spirits that are

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[835] Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

[836] Sec. 7701(a)(9).

[837] Sec. 199(d)(8)(A).

[838] Sec. 199(d)(8)(B).

[839] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See secs. 5002(a)(10) and (11).

[840] Sec. 5001(a)(1).

exported from the United States, including exports to U.S. possessions (*e.g.*, Puerto Rico and the Virgin Islands).[841]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[842] The amount of the cover over is limited under Code section 7652(f) to \$10.50 per proof gallon (\$13.25 per proof gallon before January 1, 2017).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[843] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[844] All of the amounts covered over are subject to the limitation.

Description of Proposal

The proposal suspends for six years the \$10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the proposal, the cover-over limitation of \$13.25 per proof gallon is extended for rum brought into the United States after December 31, 2016 and before January 1, 2023. After December 31, 2022, the cover over amount reverts to \$10.50 per proof gallon.

Effective Date

The proposal applies to distilled spirits brought into the United States after December 31, 2016.

3. Extension of American Samoa economic development credit

Present Law

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the corporation's economic activity-based limitation

[841] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

[842] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

[843] Sec. 7652(e)(2).

[844] Secs. 7652(a)(3), (b)(3), and (e)(1).

with respect to American Samoa. The credit is not part of the Code but is computed based on the rules of sections 30A and 936. The credit is allowed for the first eleven taxable years of a corporation that begin after December 31, 2005, and before January 1, 2017.

A corporation was an existing credit claimant with respect to a American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit[845] in an election in effect for its taxable year that included October 13, 1995.[846] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the proposal is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified

[845] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b) and 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936. Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

[846] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the proposal.

For taxable years beginning after December 31, 2016 the credit rules are modified in two ways. First, domestic corporations with operations in American Samoa are allowed the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

In the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, the credit applies to the first nine taxable years of the corporation which begin after December 31, 2005, and before January 1, 2017. For any other corporation, the credit applies to the first three taxable years of that corporation which begin after December 31, 2011 and before January 1, 2017.

Description of Proposal

The proposal extends the credit for five years to apply (a) in the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, to the first 17 taxable years of the corporation which begin after December 31, 2005, and before January 1, 2023, and (b) in the case of any other corporation, to the first 11 taxable years of the corporation which begin after December 31, 2011 and before January 1, 2023.

Effective Date

The proposal applies to taxable years beginning after December 31, 2016.

F. Other International Reforms

1. Restriction on insurance business exception to the passive foreign investment company rules

Description of Proposal

The proposal modifies the requirements for a corporation the income of which is not included in passive income for purposes of the PFIC rules. The proposal replaces the test based on whether a corporation is predominantly engaged in an insurance business with a test based on the corporation's insurance liabilities. The requirement that the foreign corporation would be subject to tax under subchapter L if it were a domestic corporation is retained.

Under the proposal, passive income for purposes of the PFIC rules does not include income derived in the active conduct of an insurance business by a corporation (1) that would be subject to tax under subchapter L if it were a domestic corporation; and (2) the applicable insurance liabilities of which constitute more than 25 percent of its total assets as reported on the company's applicable financial statement for the last year ending with or within the taxable year.

For the purpose of the proposal's exception from passive income, applicable insurance liabilities means, with respect to any property and casualty or life insurance business (1) loss and loss adjustment expenses, (2) reserves (other than deficiency, contingency, or unearned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks. This includes loss reserves for property and casualty, life, and health insurance contracts and annuity contracts. Unearned premium reserves with respect to any type of risk are not treated as applicable insurance liabilities for purposes of the proposal. For purposes of the proposal, the amount of any applicable insurance liability may not exceed the lesser of such amount (1) as reported to the applicable insurance regulatory body in the applicable financial statement (or, if less, the amount required by applicable law or regulation), or (2) as determined under regulations prescribed by the Secretary.

An applicable financial statement is a statement for financial reporting purposes that (1) is made on the basis of generally accepted accounting principles, (2) is made on the basis of international financial reporting standards, but only if there is no statement made on the basis of generally accepted accounting principles, or (3) except as otherwise provided by the Secretary in regulations, is the annual statement required to be filed with the applicable insurance regulatory body, but only if there is no statement made on either of the foregoing bases. Unless otherwise provided in regulations, it is intended that generally accepted accounting principles means U.S. GAAP.

The applicable insurance regulatory body means, with respect to any insurance business, the entity established by law to license, authorize, or regulate such insurance business and to which the applicable financial statement is provided. For example, in the United States, the applicable insurance regulatory body is the State insurance regulator to which the corporation provides its annual statement.

If a corporation fails to qualify solely because its applicable insurance liabilities constitute 25 percent or less of its total assets, a United States person who owns stock of the corporation may elect in such manner as the Secretary prescribes to treat the stock as stock of a qualifying insurance corporation if (1) the corporation's applicable insurance liabilities constitute at least 10 percent of its total assets, and (2) based on the applicable facts and circumstances, the corporation is predominantly engaged in an insurance business, and its failure to qualify under the 25 percent threshold is due solely to runoff-related or rating-related circumstances involving such insurance business. Such circumstances include, for example, the fact that the company is in runoff, that is, it is not taking on new insurance business (and consequently has little or no premium income), and is using its remaining assets to pay off claims with respect to pre-existing insurance risks on its books. Such circumstances also include, for example, the application to the company of specific requirements with respect to capital and surplus relating to insurance liabilities imposed by a rating agency as a condition of obtaining a rating necessary to write new insurance business for the current year.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

2. Limitation on treaty benefits for certain deductible payments

Description of Proposal

The proposal limits tax treaty benefits with respect to U.S. withholding tax imposed on deductible related-party payments. Under the proposal, the amount of U.S. withholding tax imposed on deductible related-party payments may not be reduced under any U.S. income tax treaty unless such withholding tax would have been reduced under a U.S. income tax treaty if the payment were made directly to the foreign parent corporation of the payee. A payment is a deductible related-party payment if it is made directly or indirectly by any person to any other person, if it is allowable as a deduction for U.S. tax purposes, and if both persons are members of the same foreign controlled group of entities.

For purposes of the proposal, a foreign controlled group of entities is a controlled group of corporations as defined in section 1563(a)(1), modified as described below, in which the common parent company is a foreign corporation. Such common parent company is referred to as the foreign parent corporation. A controlled group of corporations consists of a chain or chains of corporations connected through direct stock ownership of at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations. For purposes of the proposal, the relevant ownership threshold is lowered from at least 80 percent to more than 50 percent, certain members of the controlled group of corporations that would otherwise be treated as excluded members are not treated as excluded members,[847] and insurance companies are not

[847] Under section 1563(b)(2), a corporation that is a member of a controlled group of corporations on December 31 of a taxable year is treated as an excluded member of the group for the taxable year that includes such December 31 if such corporation (A) is a member of the group for less than one-half the number of days in such taxable year which precedes such December 31; (B) is exempt from taxation under section 501(a) for such taxable

treated as members of a separate controlled group of corporations. In addition, a partnership or other noncorporate entity is treated as a member of a controlled group of corporations if such entity is controlled (within the meaning of section 954(d)(3)) by members of the group.

The Secretary may prescribe regulations or other guidance as are necessary or appropriate to carry out the purposes of the proposal, including regulations or other guidance providing for the treatment of two or more persons as members of a foreign controlled group of entities if such persons would be the common parent of such group if treated as one corporation, and regulations providing for the treatment of any member of a foreign controlled group of entities as the common parent of that group if such treatment is appropriate taking into account the economic relationships among the group entities.

As an example of the operation of the proposal, a deductible payment made by a U.S. entity to an intermediate foreign entity (the payee) with a foreign parent corporation that is resident in a country with respect to which the United States does not have an income tax treaty is always subject to the statutory U.S. withholding tax rate of 30 percent, irrespective of whether the payee qualifies for benefits under a tax treaty. If, instead, the foreign parent corporation is a resident of a country with respect to which the United States does have an income tax treaty that would reduce the withholding tax rate on a payment made directly to the foreign parent corporation (regardless of the amount of such reduction), and the payment would qualify for benefits under that treaty if the payment were made directly to the foreign parent corporation, then the payee entity will continue to be eligible for the reduced withholding tax rate under the U.S. income tax treaty with the payee entity's residence country (even if such reduced treaty rate is lower than the rate that would be imposed on a hypothetical direct payment to the foreign parent corporation).

Effective Date

The proposal is effective for payments made after the date of enactment.

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year; (C) is a foreign corporation subject to tax under section 881 for such taxable year; (D) is an insurance company subject to taxation under section 801; or (E) is a franchised corporation (as defined in section 1563(f)(4)).

TITLE V − EXEMPT ORGANIZATIONS

A. Unrelated Business Income Tax

1. Clarification of unrelated business income tax treatment of entities exempt from tax under section 501(a)

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Section 115 excludes from gross income certain income of entities that perform an essential government function. The exemption applies to: (1) income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia; or (2) income accruing to the government of any possession of the United States, or any political subdivision thereof.

Unrelated business income tax, in general

An exempt organization generally may have revenue from four sources: contributions, gifts, and grants; trade or business income that is related to exempt activities (*e.g.*, program service revenue); investment income; and trade or business income that is not related to exempt activities. The Federal income tax exemption generally extends to the first three categories, and does not extend to an organization's unrelated trade or business income. In some cases, however, the investment income of an organization is taxed as if it were unrelated trade or business income.[848]

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[849] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore,

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[848] This is the case for social clubs (sec. 501(c)(7)), voluntary employees' beneficiary associations (sec. 501(c)(9)), and organizations and trusts described in sections 501(c)(17) and 501(c)(20). Sec. 512(a)(3).

[849] Secs. 511-514.

an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[850] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts);[851] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[852] and (3) certain State colleges and universities.[853]

Description of Proposal

The proposal clarifies that an organization does not fail to be subject to tax on its unrelated business income as an organization exempt from tax under section 501(a) solely because the organization also is exempt, or excludes amounts from gross income, by reason of another provision of the Code. For example, if an organization is described in section 401(a) (and thus is exempt from tax under section 501(a)) and its income also is described in section 115 (relating to the exclusion from gross income of certain income derived from the exercise of an essential governmental function), its status under section 115 does not cause it to be exempt from tax on its unrelated business income.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Exclusion of research income from unrelated business taxable income limited to publicly available research

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare

[850] Treas. Reg. sec. 1.501(c)(3)-1(e).

[851] Sec. 511(a)(2)(A).

[852] Sec. 511(a)(2)(A).

[853] Sec. 511(a)(2)(B).

organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[854] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[855] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts);[856] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[857] and (3) certain State colleges and universities.[858]

Exclusions from Unrelated Business Taxable Income

In general

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[859] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[860] Other exemptions from UBIT are

[854] Secs. 511-514.

[855] Treas. Reg. sec. 1.501(c)(3)-1(e).

[856] Sec. 511(a)(2)(A).

[857] Sec. 511(a)(2)(A).

[858] Sec. 511(a)(2)(B).

[859] Secs. 511-514.

[860] Sec. 512(b)(13).

provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Research income

Certain income derived from research activities of exempt organizations is excluded from unrelated business taxable income. For example, income derived from research performed for the United States, a State, and certain agencies and subdivisions is excluded.[861] Income from research performed by a college, university, or hospital for any person also is excluded.[862] Finally, if an organization is operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, all income derived by research performed by such organization for any person, not just income derived from research available to the general public, is excluded.[863]

Description of Proposal

The proposal modifies the exclusion of income from research performed by an organization operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public (section 512(b)(9)). Under the proposal, the organization may exclude from unrelated business taxable income under section 512(b)(9) only income from such fundamental research the results of which are freely available to the general public.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

[861] Sec. 512(b)(7).

[862] Sec. 512(b)(8).

[863] Sec. 512(b)(9).

B. Excise Taxes

1. Simplification of excise tax on private foundation investment income

Present Law

Excise tax on the net investment income of private foundations

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations[864]) are subject to a two-percent excise tax on their net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[865] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[866] In addition, the foundation cannot have been subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[867]

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[864] Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[865] Sec. 4942(g).

[866] Sec. 4940(e).

[867] Sec. 4942(d)(2).

Description of Proposal

The proposal replaces the two rates of excise tax on tax-exempt private foundations with a single rate of tax of 1.4 percent. Thus, under the proposal, a tax-exempt private foundation generally is subject to an excise tax of 1.4 percent on its net investment income. A taxable private foundation is subject to an excise tax equal to the excess (if any) of the sum of the 1.4-percent net investment income excise tax and the amount of the tax on unrelated business income (both calculated as if the foundation were tax-exempt), over the income tax imposed on the foundation. The proposal repeals the special reduced excise tax rate for private foundations that exceed their historical level of qualifying distributions.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Private operating foundation requirements relating to operation of an art museum

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[868] Certain organizations are classified as public charities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.[869] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[870] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[871] A supporting organization, *i.e.*, an

[868] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[869] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[870] Treas. Reg. sec. 1.170A-9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A-9(f)(3).

[871] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment

organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets certain other requirements of the Code, also is classified as a public charity.[872]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities.[873]

Tax on failure to distribute income by private nonoperating foundations

Private nonoperating foundations are required to pay out a minimum amount each year as qualifying distributions.[874] In general, a qualifying distribution is an amount paid to accomplish one or more of the organization's exempt purposes, including reasonable and necessary administrative expenses.[875] Failure to pay out the minimum required amount results in an initial excise tax on the foundation of 30 percent of the undistributed amount. An additional tax of 100 percent of the undistributed amount applies if an initial tax is imposed and the required distributions have not been made by the end of the applicable taxable period.[876] A foundation

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income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[872] Sec. 509(a)(3). Supporting organizations are further classified as Type I, II, or III depending on the relationship they have with the organizations they support. Supporting organizations must support public charities listed in one of the other categories (*i.e.*, *per se* public charities, broadly supported public charities, or revenue generating public charities), and they are not permitted to support other supporting organizations or testing for public safety organizations.

Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[873] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year, (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[874] Sec. 4942.

[875] Sec. 4942(g)(1)(A).

[876] Sec. 4942(a) and (b). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

may include as a qualifying distribution the salaries, occupancy expenses, travel costs, and other reasonable and necessary administrative expenses that the foundation incurs in operating a grant program. A qualifying distribution also includes any amount paid to acquire an asset used (or held for use) directly in carrying out one or more of the organization's exempt purposes and certain amounts set aside for exempt purposes.[877]

Private operating foundations

The tax on failure to distribute income does not apply to the undistributed income of a private foundation for any taxable year for which it is an operating foundation.[878] Private operating foundations generally operate their own charitable programs directly, rather than serving primarily as a grantmaking entity.

Private operating foundations must satisfy several tests designed to distinguish them from nonoperating (grantmaking) foundations. First, an operating foundation generally must make qualifying distributions for the direct conduct of activities that are related to its exempt purpose (as opposed to making such distributions in the form of grants to other charities) equal to 85 percent of the lesser of its adjusted net income or its minimum investment return, each as defined under section 4942.[879] In addition, an operating foundation must satisfy one of the following three alternative tests: (1) an asset test, under which substantially more than half of the organization's assets (generally, 65 percent) are devoted to the direct conduct of exempt activities or to functionally related businesses; (2) an endowment test, under which the organization normally makes qualifying distributions for the direct conduct of activities related to its exempt purpose in an amount not less than two-thirds of its minimum investment return; or (3) a support test, under which the organization must meet certain measures to show that it receives public support.[880]

Description of Proposal

Under the proposal, an organization that operates an art museum as a substantial activity does not qualify as a private operating foundation unless the museum is open during normal business hours to the public for at least 1,000 hours during the taxable year.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

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[877] Sec. 4942(g)(1)(B) and 4942(g)(2). In general, an organization is permitted to adjust the distributable amount in those cases where distributions during the five preceding years have exceeded the payout requirements. Sec. 4942(i).

[878] Sec. 4942(a)(1).

[879] Sec. 4942(j)(3)(A); Treas. Reg. sec. 53.4942(b)-1(c).

[880] Sec. 4942(j)(3)(B).

3. Excise tax based on investment income of private colleges and universities

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[881] Certain organizations are classified as public charities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.[882] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[883] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[884] A supporting organization, *i.e.*, an organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets the requirements of the Code, also is classified as a public charity.[885]

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[881] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[882] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[883] Treas. Reg. sec. 1.170A-9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A-9(f)(3).

[884] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[885] Sec. 509(a)(3). Supporting organizations are further classified as Type I, II, or III depending on the relationship they have with the organizations they support. Supporting organizations must support public charities listed in one of the other categories (*i.e.*, *per se* public charities, broadly supported public charities, or revenue generating public charities), and they are not permitted to support other supporting organizations or testing for public safety organizations.

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities.[886]

<u>Excise tax on investment income of private foundations</u>

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations)[887] are subject to a two-percent excise tax on their net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[888] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[889] In addition, the foundation cannot have been

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Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[886] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year, (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[887] Exempt operating foundations are exempt from the section 4940 tax. Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[888] Sec. 4942(g).

[889] Sec. 4940(e).

subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.[890]

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[891]

Private colleges and universities

Private colleges and universities generally are treated as public charities rather than private foundations[892] and thus are not subject to the private foundation excise tax on net investment income.

Description of Proposal

The proposal imposes an excise tax on an applicable educational institution for each taxable year equal to 1.4 percent of the net investment income of the institution for the taxable year. Net investment income is determined using rules similar to the rules of section 4940(c) (relating to the net investment income of a private foundation).

For purposes of the proposal, an applicable educational institution is an institution: (1) that has at least 500 students during the preceding taxable year; (2) that is an eligible education institution as described in section 25A of the Code[893]; (3) that is not described in the first section of section 511(a)(2)(B) of the Code (generally describing State colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution's exempt purpose) is at least $100,000 per student. For these purposes, the number of students of an institution is

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890 Under a separate proposal, the private foundation excise tax would be simplified by replacing the two-tier rate structure with a single-rate tax set at 1.4 percent.

891 Sec. 4942(d)(2).

892 Secs. 509(a)(1) and 170(b)(1)(A)(ii).

893 Section 25A defines an eligible educational institution as an institution (1) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1977, and (2) which is eligible to participate in a program under title IV of such Act.

based on the daily average number of full-time students attending the institution, with part-time students being taken into account on a full-time student equivalent basis.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Provide an exception to the private foundation excess business holdings rules for philanthropic business holdings

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code") is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[894] Certain organizations are classified as public charities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations (including medical research organizations), certain organizations providing assistance to colleges and universities, and governmental units.[895] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[896] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[897] A supporting organization, *i.e.*, an organization that provides support to another section 501(c)(3) entity that is

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[894] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[895] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[896] Treas. Reg. sec. 1.170A-9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A-9(f)(3).

[897] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

not a private foundation and meets certain other requirements of the Code, also is classified as a public charity.[898]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities, as well as a tax on their net investment income.[899]

Excess business holdings of private foundations

Private foundations are subject to tax on excess business holdings.[900] In general, a private foundation is permitted to hold 20 percent of the voting stock in a corporation, reduced by the amount of voting stock held by all disqualified persons (as defined in section 4946). If it is established that no disqualified person has effective control of the corporation, a private foundation and disqualified persons together may own up to 35 percent of the voting stock of a corporation. A private foundation shall not be treated as having excess business holdings in any corporation if it owns (together with certain other related private foundations) not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock in that corporation. Similar rules apply with respect to holdings in a partnership (substituting "profits interest" for "voting stock" and "capital interest" for "nonvoting stock") and to other unincorporated enterprises (by substituting "beneficial interest" for "voting stock"). Private foundations are not permitted to have holdings in a proprietorship. Foundations generally have a five-year period to dispose of excess business holdings (acquired other than by purchase) without being subject to tax.[901] This five-year period may be extended an additional five years in limited circumstances.[902] The excess business holdings rules do not apply to

[898] Sec. 509(a)(3). Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[899] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[900] Sec. 4943. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[901] Sec. 4943(c)(6).

[902] Sec. 4943(c)(7).

holdings in a functionally related business or to holdings in a trade or business at least 95 percent of the gross income of which is derived from passive sources.[903]

The initial tax is equal to five percent of the value of the excess business holdings held during the foundation's applicable taxable year. An additional tax is imposed if an initial tax is imposed and at the close of the applicable taxable period, the foundation continues to hold excess business holdings. The amount of the additional tax is equal to 200 percent of such holdings.

Description of Proposal

The proposal creates an exception to the excess business holdings rules for certain philanthropic business holdings. Specifically, the tax on excess business holdings does not apply with respect to the holdings of a private foundation in any business enterprise that, for the taxable year, satisfies the following requirements: (1) the ownership requirements; (2) the "all profits to charity" distribution requirement; and (3) the independent operation requirements.

The ownership requirements are satisfied if: (1) all ownership interests in the business enterprise are held by the private foundation at all times during the taxable year; and (2) all the private foundation's ownership interests in the business enterprise were acquired not by purchase.

The "all profits to charity" distribution requirement is satisfied if the business enterprise, not later than 120 days after the close of the taxable year, distributes an amount equal to its net operating income for such taxable year to the private foundation. For this purpose, the net operating income of any business enterprise for any taxable year is an amount equal to the gross income of the business enterprise for the taxable year, reduced by the sum of: (1) the deductions allowed by chapter 1 of the Code for the taxable year that are directly connected with the production of the income; (2) the tax imposed by chapter 1 on the business enterprise for the taxable year; and (3) an amount for a reasonable reserve for working capital and other business needs of the business enterprise.

The independent operation requirements are met if, at all times during the taxable year, the following three requirements are satisfied. First, no substantial contributor to the private foundation, or family member of such a contributor, is a director, officer, trustee, manager, employee, or contractor of the business enterprise (or an individual having powers or responsibilities similar to any of the foregoing). Second, at least a majority of the board of directors of the private foundation are not also directors or officers of the business enterprise or members of the family of a substantial contributor to the private foundation. Third, there is no loan outstanding from the business enterprise to a substantial contributor to the private foundation or a family member of such contributor. For purposes of the independent operation requirements, "substantial contributor" has the meaning given to the term under section 4958(c)(3)(C), and family members are determined under section 4958(f)(4).

The proposal does not apply to the following organizations: (1) donor advised funds or supporting organizations that are subject to the excess business holdings rules by reason of

[903] Sec. 4943(d)(3).

section 4943(e) or (f); (2) any trust described in section 4947(a)(1) (relating to charitable trusts); or (3) any trust described in section 4947(a)(2) (relating to split-interest trusts).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

C. Requirements for Organizations Exempt From Tax

1. Churches and certain other organizations permitted to make statements relating to political campaign in ordinary course of activities in carrying out exempt purpose

Present Law

Section 501(c)(3) organizations

Charitable organizations, *i.e.*, organizations described in section 501(c)(3), generally are exempt from Federal income tax and are eligible to receive tax deductible contributions. A charitable organization must operate primarily in pursuance of one or more tax-exempt purposes constituting the basis of its tax exemption.[904] The Code specifies such purposes as religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international amateur sports competition, or for the prevention of cruelty to children or animals.[905] In general, an organization is organized and operated for charitable purposes if it provides relief for the poor and distressed or the underprivileged. In order to qualify as operating primarily for a purpose described in section 501(c)(3), an organization must satisfy the following operational requirements: (1) its net earnings may not inure to the benefit of any person in a position to influence the activities of the organization; (2) it must operate to provide a public benefit, not a private benefit;[906] (3) it may not be operated primarily to conduct an unrelated trade or business;[907] (4) it may not engage in substantial legislative lobbying; and (5) it may not participate or intervene in any political campaign.

Section 501(c)(3) organizations are classified either as "public charities" or "private foundations."[908] Private foundations generally are defined under section 509(a) as all organizations described in section 501(c)(3) other than an organization granted public charity status by reason of: (1) being a specified type of organization (*i.e.*, churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation. In contrast to public charities, private foundations generally are funded from a limited number of

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[904] Treas. Reg. sec. 1.501(c)(3)-1(c)(1).

[905] Treas. Reg. sec. 1.501(c)(3)-1(d)(2).

[906] Treas. Reg. sec. 1.501(c)(3)-1(d)(1)(ii).

[907] Treas. Reg. sec. 1.501(c)(3)-1(e)(1). Conducting a certain level of unrelated trade or business activity will not jeopardize tax-exempt status.

[908] Sec. 509(a).

sources (*e.g.*, an individual, family, or corporation). Donors to private foundations and persons related to such donors together often control the operations of private foundations.

Because private foundations receive support from, and typically are controlled by, a small number of supporters, private foundations are subject to a number of anti-abuse rules and excise taxes not applicable to public charities.[909] Public charities also have certain advantages over private foundations regarding the deductibility of contributions.

Political campaign activities

Charitable organizations may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.[910] The prohibition on such political campaign activity is absolute and, in general, includes activities such as making contributions to a candidate's political campaign, endorsements of a candidate, lending employees to work in a political campaign, or providing facilities for use by a candidate. Many other activities may constitute political campaign activity, depending on the facts and circumstances. The sanction for a violation of the prohibition is loss of the organization's tax-exempt status.

For organizations that engage in prohibited political campaign activity, the Code provides three penalties that may be applied either as alternatives to revocation of tax exemption or in addition to loss of tax-exempt status: an excise tax on political expenditures,[911] termination assessment of all taxes due,[912] and an injunction against further political expenditures.[913]

Description of Proposal

The proposal modifies the present-law rules relating to political campaign activity by churches, their integrated auxiliaries, and conventions or associations of churches for the following purposes: (1) section 501(c)(3) status; (2) qualifying as an eligible recipient of tax-

[909] Secs. 4940-4945.

[910] Sec. 501(c)(3).

[911] Sec. 4955.

[912] Sec. 6852(a)(1).

[913] Sec. 7409.

deductible contributions for income,[914] gift,[915] and estate tax[916] purposes; and (3) application of the excise tax on political expenditures by section 501(c)(3) organizations.[917]

For such purposes, a church, an integrated auxiliary of a church, or a convention or association of churches shall not fail to be treated as organized and operated exclusively for a religious purpose, nor shall it be deemed to have participated in, or intervened in any political campaign on behalf of (or in opposition to) any candidate for public office, solely because of the content of any homily, sermon, teaching, dialectic, or other presentation made during religious services or gatherings, but only if the preparation and presentation of such content: (A) is in the ordinary course of the organization's regular and customary activities in carrying out its exempt purpose; and (B) results in the organization incurring not more than *de minimis* incremental expenses.

Effective Date

The proposal is effective for taxable years ending after the date of enactment.

2. Additional reporting requirements for donor advised fund sponsoring organizations

Present Law

Overview

Some charitable organizations (including community foundations) establish accounts to which donors may contribute and thereafter provide nonbinding advice or recommendations with regard to distributions from the fund or the investment of assets in the fund. Such accounts are commonly referred to as "donor advised funds." Donors who make contributions to charities for maintenance in a donor advised fund generally claim a charitable contribution deduction at the time of the contribution.[918] Although sponsoring charities frequently permit donors (or other

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[914] Sec. 170(c)(2).

[915] Sec. 2522.

[916] Secs. 2055 and 2106.

[917] Sec. 4955.

[918] Contributions to a sponsoring organization for maintenance in a donor advised fund are not eligible for a charitable deduction for income tax purposes if the sponsoring organization is a veterans' organization described in section 170(c)(3), a fraternal society described in section 170(c)(4), or a cemetery company described in section 170(c)(5); for gift tax purposes if the sponsoring organization is a fraternal society described in section 2522(a)(3) or a veterans' organization described in section 2522(a)(4); or for estate tax purposes if the sponsoring organization is a fraternal society described in section 2055(a)(3) or a veterans' organization described in section 2055(a)(4). In addition, contributions to a sponsoring organization for maintenance in a donor advised fund are not eligible for a charitable deduction for income, gift, or estate tax purposes if the sponsoring organization is a Type III supporting organization (other than a functionally integrated Type III supporting organization). In addition to satisfying generally applicable substantiation requirements under section 170(f), a donor must obtain, with respect to each charitable contribution to a sponsoring organization to be maintained in a donor advised fund, a contemporaneous

persons appointed by donors) to provide nonbinding recommendations concerning the distribution or investment of assets in a donor advised fund, sponsoring charities generally must have legal ownership and control of such assets following the contribution. If the sponsoring charity does not have such control (or permits a donor to exercise control over amounts contributed), the donor's contributions may not qualify for a charitable deduction, and, in the case of a community foundation, the contribution may be treated as being subject to a material restriction or condition by the donor.

Statutory definition of a donor advised fund

The Code defines a "donor advised fund" as a fund or account that is: (1) separately identified by reference to contributions of a donor or donors; (2) owned and controlled by a sponsoring organization; and (3) with respect to which a donor (or any person appointed or designated by such donor (a "donor advisor")) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the separately identified fund or account by reason of the donor's status as a donor. All three prongs of the definition must be met in order for a fund or account to be treated as a donor advised fund.[919]

A "sponsoring organization" is an organization that: (1) is described in section 170(c)[920] (other than a governmental entity described in section 170(c)(1), and without regard to any requirement that the organization be organized in the United States[921]); (2) is not a private foundation (as defined in section 509(a)); and (3) maintains one or more donor advised funds.[922]

Reporting and disclosure

Each sponsoring organization must disclose on its information return: (1) the total number of donor advised funds it owns; (2) the aggregate value of assets held in those funds at the end of the organization's taxable year; and (3) the aggregate contributions to and grants made

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written acknowledgment from the sponsoring organization providing that the sponsoring organization has exclusive legal control over the assets contributed.

[919] See sec. 4966(d)(2)(A). A donor advised fund does not include a fund or account that makes distributions only to a single identified organization or governmental entity. A donor advised fund also does not include certain funds or accounts with respect to which a donor or donor advisor provides advice as to which individuals receive grants for travel, study, or other similar purposes. In addition, the Secretary may exempt a fund or account from treatment as a donor advised fund if such fund or account is advised by a committee not directly or indirectly controlled by a donor, donor advisor, or persons related to a donor or donor advisor. The Secretary also may exempt a fund or account from treatment as a donor advised fund if such fund or account benefits a single identified charitable purpose. Secs. 4966(d)(2)(B) and (C).

[920] Section 170(c) describes organizations to which charitable contributions that are deductible for income tax purposes can be made.

[921] See sec. 170(c)(2)(A).

[922] Sec. 4966(d)(1).

from those funds during the year.[923] In addition, when seeking recognition of its tax-exempt status, a sponsoring organization must disclose whether it intends to maintain donor advised funds.[924]

Description of Proposal

The proposal requires a sponsoring organization to report additional information on its annual information return (Form 990). Sponsoring organizations must indicate: (1) the average amount of grants made from donor advised funds during the taxable year (expressed as a percentage of the value of assets held in such funds at the beginning of the taxable year), and (2) whether the organization has a policy with respect to donor advised funds relating to the frequency and minimum level of distributions from donor advised funds. The sponsoring organization must include with its return a copy of any such policy.

Effective Date

The proposal is effective for returns filed for taxable years beginning after December 31, 2017.

[923] Sec. 6033(k).

[924] Sec. 508(f).

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1,
THE "TAX CUTS AND JOBS ACT,"
SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017

Calendar Year 2019

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..........	-$557	-7.9%	$7.0	0.2%	$6.5	0.2%	9.1%	8.4%
$10,000 to $20,000.........	-$2,435	(5)	-$2.4	-0.1%	-$4.8	-0.2%	-0.7%	-1.4%
$20,000 to $30,000.........	-$3,001	-13.6%	$22.1	0.7%	$19.1	0.6%	3.9%	3.4%
$30,000 to $40,000.........	-$4,181	-8.9%	$47.0	1.5%	$42.8	1.4%	7.9%	7.2%
$40,000 to $50,000.........	-$5,532	-8.2%	$67.3	2.1%	$61.7	2.0%	10.9%	10.0%
$50,000 to $75,000.........	-$20,921	-7.9%	$265.3	8.2%	$244.4	8.0%	14.8%	13.6%
$75,000 to $100,000.......	-$19,483	-7.0%	$279.5	8.7%	$260.1	8.6%	17.0%	15.8%
$100,000 to $200,000......	-$57,066	-6.1%	$939.8	29.1%	$882.7	29.1%	20.9%	19.6%
$200,000 to $500,000......	-$26,446	-3.7%	$724.3	22.4%	$697.8	23.0%	26.4%	25.3%
$500,000 to $1,000,000...	-$10,912	-4.3%	$254.7	7.9%	$243.8	8.0%	30.9%	29.4%
$1,000,000 and over........	-$41,557	-6.7%	$624.1	19.3%	$582.5	19.2%	32.5%	29.9%
Total, All Taxpayers.......	**-$192,092**	**-5.9%**	**$3,228.7**	**100.0%**	**$3,036.7**	**100.0%**	**20.7%**	**19.4%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-47-17, excluding the following sections under I. Tax Reform for Individuals: B.2.c., C.2., C.3., E.1.- E.6., F.1 - F.6., and H.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$2.412 billion to -$4.848 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1, THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017

Calendar Year 2021

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..........	-$422	-6.1%	$6.9	0.2%	$6.5	0.2%	8.2%	7.7%
$10,000 to $20,000.........	-$2,084	(5)	-$4.9	-0.1%	-$7.0	-0.2%	-1.4%	-1.9%
$20,000 to $30,000.........	-$2,636	-11.7%	$22.5	0.6%	$19.9	0.6%	3.7%	3.3%
$30,000 to $40,000.........	-$3,695	-7.7%	$47.7	1.4%	$44.0	1.3%	7.6%	7.0%
$40,000 to $50,000.........	-$5,281	-7.2%	$73.7	2.1%	$68.4	2.1%	10.9%	10.1%
$50,000 to $75,000.........	-$20,189	-7.1%	$283.4	8.1%	$263.3	7.9%	14.7%	13.6%
$75,000 to $100,000.......	-$18,029	-6.0%	$300.3	8.6%	$282.3	8.5%	16.8%	15.8%
$100,000 to $200,000......	-$51,751	-5.1%	$1,017.6	29.1%	$965.8	29.0%	20.9%	19.8%
$200,000 to $500,000......	-$18,670	-2.3%	$799.8	22.9%	$781.1	23.4%	26.5%	25.8%
$500,000 to $1,000,000...	-$7,806	-2.8%	$279.4	8.0%	$271.6	8.1%	31.0%	30.1%
$1,000,000 and over........	-$33,346	-5.0%	$671.8	19.2%	$638.5	19.1%	32.4%	30.7%
Total, All Taxpayers.......	**-$163,909**	**-4.7%**	**$3,498.3**	**100.0%**	**$3,334.4**	**100.0%**	**20.7%**	**19.7%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-47-17, excluding the following sections under I. Tax Reform for Individuals: B.2.c., C.2., C.3., E.1.- E.6., F.1 - F.6., and H.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$4.888 billion to -$6.972 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1, THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017

Calendar Year 2023

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..........	$100	1.6%	$6.4	0.2%	$6.5	0.2%	7.0%	7.1%
$10,000 to $20,000.........	$638	(5)	-$5.0	-0.1%	-$4.4	-0.1%	-1.3%	-1.1%
$20,000 to $30,000.........	$1,170	4.7%	$24.7	0.7%	$25.8	0.7%	3.7%	3.9%
$30,000 to $40,000.........	$653	1.3%	$51.0	1.4%	$51.7	1.4%	7.6%	7.7%
$40,000 to $50,000.........	-$300	-0.4%	$80.9	2.1%	$80.6	2.2%	10.8%	10.8%
$50,000 to $75,000.........	-$6,359	-2.1%	$305.2	8.1%	$298.8	8.0%	14.6%	14.3%
$75,000 to $100,000.......	-$4,475	-1.4%	$325.9	8.6%	$321.4	8.6%	16.6%	16.4%
$100,000 to $200,000......	-$17,442	-1.6%	$1,103.4	29.3%	$1,086.0	29.0%	20.8%	20.5%
$200,000 to $500,000......	$3,405	0.4%	$863.6	22.9%	$867.0	23.2%	26.5%	26.5%
$500,000 to $1,000,000...	$744	0.3%	$297.6	7.9%	$298.3	8.0%	30.8%	30.8%
$1,000,000 and over........	-$8,885	-1.2%	$717.5	19.0%	$708.7	18.9%	32.2%	31.7%
Total, All Taxpayers.......	**-$30,752**	**-0.8%**	**$3,771.1**	**100.0%**	**$3,740.3**	**100.0%**	**20.5%**	**20.3%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-47-17, excluding the following sections under I. Tax Reform for Individuals: B.2.c., C.2., C.3., E.1.- E.6., F.1 - F.6., and H.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would increase from -$5.044 billion to -$4.406 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1, THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017

Calendar Year 2025

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..........	-$80	-1.4%	$5.9	0.1%	$5.8	0.1%	5.8%	5.7%
$10,000 to $20,000.........	$268	(5)	-$4.7	-0.1%	-$4.4	-0.1%	-1.1%	-1.1%
$20,000 to $30,000.........	$1,070	3.9%	$27.2	0.7%	$28.3	0.7%	3.8%	4.0%
$30,000 to $40,000.........	$388	0.7%	$53.7	1.3%	$54.1	1.3%	7.5%	7.6%
$40,000 to $50,000.........	-$679	-0.8%	$88.0	2.2%	$87.3	2.2%	10.9%	10.8%
$50,000 to $75,000.........	-$8,103	-2.5%	$328.1	8.0%	$320.0	7.9%	14.5%	14.1%
$75,000 to $100,000.......	-$6,128	-1.7%	$350.6	8.6%	$344.4	8.6%	16.5%	16.2%
$100,000 to $200,000......	-$23,309	-1.9%	$1,197.4	29.3%	$1,174.1	29.1%	20.7%	20.3%
$200,000 to $500,000......	-$2,228	-0.2%	$943.3	23.1%	$941.0	23.4%	26.5%	26.4%
$500,000 to $1,000,000...	-$2,883	-0.9%	$321.5	7.9%	$318.6	7.9%	30.8%	30.5%
$1,000,000 and over........	-$21,694	-2.8%	$780.2	19.1%	$758.5	18.8%	32.1%	31.2%
Total, All Taxpayers......	**-$63,379**	**-1.5%**	**$4,091.1**	**100.0%**	**$4,027.7**	**100.0%**	**20.5%**	**20.2%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

----

(1) This table is a distributional analysis of the proposal in revenue table JCX-47-17, excluding the following sections under I. Tax Reform for Individuals: B.2.c., C.2., C.3., E.1.- E.6., F.1 - F.6., and H.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would increase from -$4.664 billion to -$4.397 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1, THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 6, 2017

Calendar Year 2027

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..........	-$518	-9.9%	$5.2	0.1%	$4.7	0.1%	4.7%	4.2%
$10,000 to $20,000.........	-$726	(5)	-$3.4	-0.1%	-$4.1	-0.1%	-0.8%	-1.0%
$20,000 to $30,000.........	$431	1.4%	$31.4	0.7%	$31.8	0.7%	4.1%	4.1%
$30,000 to $40,000.........	-$443	-0.7%	$59.4	1.3%	$59.0	1.4%	7.6%	7.6%
$40,000 to $50,000.........	-$1,902	-1.9%	$98.0	2.2%	$96.1	2.2%	11.0%	10.8%
$50,000 to $75,000.........	-$11,501	-3.3%	$352.2	7.9%	$340.7	7.9%	14.5%	14.0%
$75,000 to $100,000.......	-$9,545	-2.5%	$380.3	8.6%	$370.8	8.6%	16.3%	15.9%
$100,000 to $200,000......	-$34,747	-2.7%	$1,302.4	29.3%	$1,267.6	29.3%	20.7%	20.1%
$200,000 to $500,000......	-$12,881	-1.3%	$1,026.5	23.1%	$1,013.6	23.4%	26.6%	26.2%
$500,000 to $1,000,000...	-$7,337	-2.1%	$345.7	7.8%	$338.3	7.8%	30.8%	30.1%
$1,000,000 and over........	-$36,617	-4.3%	$848.7	19.1%	$812.0	18.8%	32.1%	30.6%
Total, All Taxpayers.......	**-$115,787**	**-2.6%**	**$4,446.4**	**100.0%**	**$4,330.6**	**100.0%**	**20.5%**	**20.0%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

----

(1) This table is a distributional analysis of the proposal in revenue table JCX-47-17, excluding the following sections under I. Tax Reform for Individuals: B.2.c., C.2., C.3., E.1.- E.6., F.1 - F.6., and H.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$3.415 billion to -$4.141 billion.

(6) Less than 0.05%.

COMPONENTS OF THE DISTRIBUTION EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R.1, THE "TAX CUTS AND JOBS ACT,"

Distribution of Individual Income Tax Side of the Proposal

	CHANGE IN FEDERAL TAXES ($ millions)				
INCOME CATEGORY	2019	2021	2023	2025	2027
Less than $10,000.............	-$287	-$252	-$118	-$120	-$315
$10,000 to $20,000.............	-$1,817	-$1,731	-$134	$111	-$189
$20,000 to $30,000.............	-$2,314	-$2,136	$782	$1,235	$1,444
$30,000 to $40,000.............	-$3,278	-$3,027	$347	$699	$857
$40,000 to $50,000.............	-$4,393	-$4,383	-$496	-$158	-$106
$50,000 to $75,000.............	-$17,046	-$17,139	-$6,622	-$6,151	-$5,607
$75,000 to $100,000...........	-$14,690	-$14,377	-$4,642	-$3,853	-$2,930
$100,000 to $200,000..........	-$39,491	-$38,341	-$17,695	-$14,944	-$11,179
$200,000 to $500,000..........	-$8,643	-$5,738	$1,076	$4,183	$7,190
$500,000 to $1,000,000.......	-$2,794	-$2,280	-$1,687	-$1,150	-$74
$1,000,000 and over............	-$18,914	-$19,379	-$18,877	-$19,916	-$20,550
Total, All Taxpayers..........	-$113,667	-$108,784	-$48,068	-$40,065	-$31,460

Distribution of Business Side of the Proposal

	CHANGE IN FEDERAL TAXES ($ millions)				
INCOME CATEGORY	2019	2021	2023	2025	2027
Less than $10,000.............	-$270	-$170	$218	$40	-$203
$10,000 to $20,000.............	-$618	-$353	$773	$156	-$538
$20,000 to $30,000.............	-$687	-$500	$388	-$165	-$1,013
$30,000 to $40,000.............	-$903	-$668	$307	-$310	-$1,300
$40,000 to $50,000.............	-$1,139	-$898	$196	-$521	-$1,795
$50,000 to $75,000.............	-$3,875	-$3,050	$263	-$1,952	-$5,894
$75,000 to $100,000...........	-$4,794	-$3,652	$167	-$2,275	-$6,615
$100,000 to $200,000..........	-$17,575	-$13,410	$253	-$8,365	-$23,568
$200,000 to $500,000..........	-$17,803	-$12,933	$2,329	-$6,412	-$20,071
$500,000 to $1,000,000.......	-$8,118	-$5,526	$2,431	-$1,732	-$7,263
$1,000,000 and over............	-$22,643	-$13,966	$9,992	-$1,778	-$16,067
Total, All Taxpayers..........	-$78,425	-$55,125	$17,316	-$23,314	-$84,327

Distribution of the Proposal

	CHANGE IN FEDERAL TAXES ($ millions)				
INCOME CATEGORY	2019	2021	2023	2025	2027
Less than $10,000.............	-$557	-$422	$100	-$80	-$518
$10,000 to $20,000.............	-$2,435	-$2,084	$638	$268	-$726
$20,000 to $30,000.............	-$3,001	-$2,636	$1,170	$1,070	$431
$30,000 to $40,000.............	-$4,181	-$3,695	$653	$388	-$443
$40,000 to $50,000.............	-$5,532	-$5,281	-$300	-$679	-$1,902
$50,000 to $75,000.............	-$20,921	-$20,189	-$6,359	-$8,103	-$11,501
$75,000 to $100,000...........	-$19,483	-$18,029	-$4,475	-$6,128	-$9,545
$100,000 to $200,000..........	-$57,066	-$51,751	-$17,442	-$23,309	-$34,747
$200,000 to $500,000..........	-$26,446	-$18,670	$3,405	-$2,228	-$12,881
$500,000 to $1,000,000.......	-$10,912	-$7,806	$744	-$2,883	-$7,337
$1,000,000 and over............	-$41,557	-$33,346	-$8,885	-$21,694	-$36,617
Total, All Taxpayers..........	-$192,092	-$163,909	-$30,752	-$63,379	-$115,787

Source: Joint Committee on Taxation

Senator Johnson's tax reform analysis

From: "McIlheran, Patrick (Ron Johnson)" <patrick_mcilheran@ronjohnson.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Sat, 04 Nov 2017 12:36:33 -0400
Attachments: tax reform analysis 171104.pdf (100.55 kB)

Dan, Senator Johnson asked that I forward to you his one-page analysis, which is attached. He sent it this morning to every Republican senator.

Pat.

Patrick McIlheran
Senior communications and policy adviser
Senator Ron Johnson
328 Hart Senate Office Building
Washington, DC 20510
(202) 228-6958

Dear Colleagues,

I've attached a one page analysis/summary of the JCT score of the House Tax Reform Plan. I've highlighted the provisions with significant deficit impacts, and roughly grouped them by their impact on: 1) Middle Class taxpayers; 2) Higher Income taxpayers; and 3) Businesses.

I've also included two scores on my Corporate Tax plan (best and worst case scenarios) for comparison purposes. I sincerely hope the Senate will give my plan serious consideration. I'm happy to provide additional information and answer any questions you might have. Ron

House tax plan

Individual taxes

dollars in billions

provision	revenue +(-)		
Tax rate changes		(1,089)	
Repeal personal exempt	1,568		
Increase standard deduc	(913)		
Child tax credit increase	(640)		
subtotal		15	
Repeal itemized deducts		1,253	
Misc other changes		207	
Middle class tax increase		386	
Repeal AMT		(695)	
Estate and gift tax		(172)	
High income net tax decrease		(867)	
total score, individual tax reform			(481)

Business taxes

dollars in billions

provision	revenue +(-)	
Corporate rate cut	(1,462)	
Pass-through cut	(448)	
Limit interest deduct	172	
Modify net oper loss	156	
repeal production deduct	95	
foreign & tax exempt modify	288	
Other biz tax modify	193	
total, business		(1,006)
total deficit score		**(1,487)**

Johnson corporate tax proposal

dollars in billions

provision	revenue +(-)	
	Best case scenario	**Worst case scenario**
C-corps treated as pass-throughs	(216)	(467)
25% backup withholding	(716)	(1,361)
House expansion of full expensing (JCT)	(11)	(11)
Repeal corporate tax expends	797	714
Repeal defer of foreign income	408	408
Deemed repatriation	260	138
Total corporate tax reform score	**522**	**(579)**

Scores are from Tax Foundation and Joint Committee on Taxation

Re: JCT Docs

From: "Angus, Barbara" <barbara.angus@mail.house.gov>
To: "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Sun, 05 Nov 2017 00:53:22 -0400

Sorry for delay. Buried in email today. b(5) [redacted]

Please let me know if you have further questions. And enjoy the weekend!

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
202.225.5522

From: "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov>
Date: Saturday, November 4, 2017 at 8:31 AM
To: Shahira Knight <Shahira Knight, EOP [redacted]>, "Angus, Barbara" <Barbara.Angus@mail.house.gov>
Subject: Re: JCT Docs

Thanks Barbara. b(5) [redacted]

From: Angus, Barbara <Barbara.Angus@mail.house.gov>
Date: November 3, 2017 at 9:52:19 PM EDT
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>, Knight, Shahira E. EOP/WHO <Shahira.E.Knight@who.eop.gov>
Subject: JCT Docs

Wanted to make sure you see these new documents from JCT – distribution analysis and technical explanation

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
1136 Longworth House Office Building
202.225.5522
barbara.angus@mail.house.gov

RE: Senator Johnson's tax reform analysis

From: "McIlheran, Patrick (Ron Johnson)" <patrick_mcilheran@ronjohnson.senate.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Sun, 05 Nov 2017 07:22:13 -0500

Very good. Thanks!

Pat
(202) 228-6958

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Sunday, November 5, 2017 7:22 AM
To: McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>
Subject: RE: Senator Johnson's tax reform analysis

It's already been done. But will use this one in the future.

From: McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>
Date: November 5, 2017 at 7:20:22 AM EST
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: RE: Senator Johnson's tax reform analysis

If you do, how about you forward this one, Dan? Some tidying-up of the labels took place. The numbers are the same, but it'll be a little easier to read.

Pat
(202) 228-6958

From: McIlheran, Patrick (Ron Johnson)
Sent: Saturday, November 4, 2017 3:24 PM
To: 'Daniel.Kowalski@treasury.gov' <Daniel.Kowalski@treasury.gov>
Subject: RE: Senator Johnson's tax reform analysis

You most certainly may.

Pat
(202) 228-6958

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Saturday, November 4, 2017 1:21 PM
To: McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>
Subject: Re: Senator Johnson's tax reform analysis

Thanks. He brought up the first part of the analysis yesterday, and mentioned that he was going to do the second. I'll take a careful look.

Can I share with folks at Treasury?

From: McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>
Date: November 4, 2017 at 12:36:43 PM EDT
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Subject: Senator Johnson's tax reform analysis

Dan, Senator Johnson asked that I forward to you his one-page analysis, which is attached. He sent it this morning to every Republican senator.

Pat.

Patrick McIlheran
Senior communications and policy adviser
Senator Ron Johnson
328 Hart Senate Office Building
Washington, DC 20510
(202) 228-6958

Dear Colleagues,

I've attached a one page analysis/summary of the JCT score of the House Tax Reform Plan. I've highlighted the provisions with significant deficit impacts, and roughly grouped them by their impact on: 1) Middle Class taxpayers; 2) Higher Income taxpayers; and 3) Businesses.

I've also included two scores on my Corporate Tax plan (best and worst case scenarios) for comparison purposes. I sincerely hope the Senate will give my plan serious consideration. I'm happy to provide additional information and answer any questions you might have. Ron

Re: RE:

From: "Specht, Brittan" <brittan.specht@mail.house.gov>
To: "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Sun, 05 Nov 2017 19:51:01 -0500

b(5) [redacted]

Brittan G. Specht, CFA
Majority Leader Kevin McCarthy

On Nov 5, 2017, at 7:50 PM, "Drew.Maloney@treasury.gov" <Drew.Maloney@treasury.gov> wrote:

b(5) [redacted]

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: (b) (6) [redacted]
drew.maloney@treasury.gov

From: Specht, Brittan <Brittan.Specht@mail.house.gov>
Date: November 5, 2017 at 7:20:09 PM EST
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: RE:

b(5) [redacted]

From: Drew.Maloney@treasury.gov [Drew.Maloney@treasury.gov]
Sent: Sunday, November 05, 2017 6:26 PM
To: Specht, Brittan
Subject:

b(5) [redacted]

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134

Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

Fwd: Legislative Text of Chairman's Amendment

From:	"DuBose, Danielle" <danielle.dubose@mail.house.gov>
To:	"Bailey, Bradley" <bradley.bailey@treasury.gov>
Date:	Mon, 06 Nov 2017 17:51:14 -0500
Attachments:	BRADTX_047_xml.pdf (97.25 kB)

Danielle DuBose

Begin forwarded message:

> **From:** "DuBose, Danielle" <Danielle.DuBose@mail.house.gov>
> **Date:** November 6, 2017 at 5:41:37 PM EST
> **To:** WAMR Tax FULL LAs <WAMRTaxFullLAs@mail.house.gov>
> **Subject: Legislative Text of Chairman's Amendment**

Hi all-

Please see attached for legislative text of the Chairman's Amendment. Please let us know if you have any questions.

Best,

Danielle

From: "DuBose, Danielle" <Danielle.DuBose@mail.house.gov>
Date: Monday, November 6, 2017 at 5:34 PM
To: WAMR Tax FULL LAs <WAMRTaxFullLAs@mail.house.gov>
Subject: Summary of Chairman's Amendment

Hi all-

See attached for summary of the amendment that the Chairman just offered.

Best,

Danielle

Danielle DuBose
Legislative Assistant- Tax Staff
Committee on Ways and Means
1136 Longworth HOB
(202) 225-5522
danielle.dubose@mail.house.gov

AMENDMENT TO THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 1 OFFERED BY MR. BRADY OF TEXAS

In section 1005(a), redesignate paragraphs (1) through (37) as paragraphs (3) through (39), respectively, and insert before such paragraph (3) (as so redesignated) the following:

(1) Section 32(b)(2)(B)(ii)(II) is amended by striking " section 1(f)(3) for the calendar year in which the taxable year begins determined by substituting 'calendar year 2008' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins determined by substituting 'calendar year 2008' for 'calendar year 2016' in clause (ii) thereof".

(2) Section 32(j)(1)(B) is amended—

(A) in the matter preceding clause (i), by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) in clause (i), by striking "for 'calendar year 1992' in subparagraph (B) thereof" and

inserting "for 'calendar year 2016' in clause (ii) thereof", and

(C) in clause (ii), by striking "for 'calendar year 1992' in subparagraph (B) of such section 1" and inserting "for 'calendar year 2016' in clause (ii) thereof".

Page 76, after line 20, insert the following:

SEC. 1104. PROCEDURES TO REDUCE IMPROPER CLAIMS OF EARNED INCOME CREDIT.

(a) CLARIFICATION REGARDING DETERMINATION OF SELF-EMPLOYMENT INCOME WHICH IS TREATED AS EARNED INCOME.—Section 32(c)(2)(B) is amended by striking "and" at the end of clause (v), by striking the period at the end of clause (vi) and inserting ", and", and by adding at the end the following new clause:

"(vii) in determining the taxpayer's net earnings from self-employment under subparagraph (A)(ii) there shall not fail to be taken into account any deduction which is allowable to the taxpayer under this subtitle.".

(b) REQUIRED QUARTERLY REPORTING OF WAGES OF EMPLOYEES.—Section 6011 is amended by adding at the end the following new subsection:

"(i) EMPLOYER REPORTING OF WAGES.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402 shall include on each return or statement submitted with respect to such tax, the name and address of such employee and the amount of wages for such employee on which such tax was withheld.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

(2) REPORTING.—The Secretary of the Treasury, or his designee, may delay the application of the amendment made by subsection (b) for such period as such Secretary (or designee) determines to be reasonable to allow persons adequate time to modify electronic (or other) systems to permit such person to comply with the requirements of such amendment.

SEC. 1105. CERTAIN INCOME DISALLOWED FOR PURPOSES OF THE EARNED INCOME TAX CREDIT.

(a) SUBSTANTIATION REQUIREMENT.—Section 32 is amended by adding at the end the following new subsection:

"(n) INCONSISTENT INCOME REPORTING.—If the earned income of a taxpayer claimed on a return for purposes of this section is not substantiated by statements or returns under sections 6051, 6052, 6041(a), or 6050W with respect to such taxpayer, the Secretary may require such taxpayer to provide books and records to substantiate such income, including for the purpose of preventing fraud.".

(b) EXCLUSION OF UNSUBSTANTIATED AMOUNT FROM EARNED INCOME.—Section 32(c)(2) is amended by adding at the end the following new subparagraph:

"(C) EXCLUSION.—In the case of a taxpayer with respect to which there is an inconsistency described in subsection (n) who fails to substantiate such inconsistency to the satisfaction of the Secretary, the term 'earned income' shall not include amounts to the extent of such inconsistency.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

Page 138, strike line 19, and all that follows through page 139, line 24, and insert the following:

SEC. 1404. SUNSET OF EXCLUSION FOR DEPENDENT CARE ASSISTANCE PROGRAMS.

(a) IN GENERAL.—Section 129 is amended by adding at the end the following new subsection:

"(f) TERMINATION.—Subsection (a) shall not apply to taxable years beginning after December 31, 2022.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

Page 246, strike lines 7 through 20, and insert the following:

(b) CONFORMING AMENDMENT.—Section 1231(b)(1)(C) is amended by inserting "a patent, invention, model or design (whether or not patented), a secret formula or process," before "a copyright".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 2017.

Page 248, after line 3, insert the following:

SEC. 3314. RECHARACTERIZATION OF CERTAIN GAINS IN THE CASE OF PARTNERSHIP PROFITS INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF INVESTMENT SERVICES.

(a) IN GENERAL.—Part IV of subchapter O of chapter 1 is amended—

(1) by redesignating section 1061 as section 1062, and

(2) by inserting after section 1060 the following new section:

"SEC. 1061. PARTNERSHIP INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF SERVICES.

"(a) IN GENERAL.—If one or more applicable partnership interests are held by a taxpayer at any time during the taxable year, the excess (if any) of—

"(1) the taxpayer's net long-term capital gain with respect to such interests for such taxable year, over

"(2) the taxpayer's net long-term capital gain with respect to such interests for such taxable year computed by applying paragraphs (3) and (4) of sections 1222 by substituting '3 years' for '1 year',

shall be treated as short-term capital gain.

"(b) SPECIAL RULE.—To the extent provided by the Secretary, subsection (a) shall not apply to income or gain

attributable to any asset not held for portfolio investment on behalf of third party investors.

"(c) APPLICABLE PARTNERSHIP INTEREST.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in this paragraph or paragraph (4), the term 'applicable partnership interest' means any interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business. The previous sentence shall not apply to an interest held by a person who is employed by another entity that is conducting a trade or business (other than an applicable trade or business) and only provides services to such other entity.

"(2) APPLICABLE TRADE OR BUSINESS.—The term 'applicable trade or business' means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of—

"(A) raising or returning capital, and

"(B) either—

"(i) investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition), or

"(ii) developing specified assets.

"(3) SPECIFIED ASSET.—The term 'specified asset' means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), commodities (as defined in section 475(e)(2)), real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing.

"(4) EXCEPTIONS.—The term 'applicable partnership interest' shall not include—

"(A) any interest in a partnership directly or indirectly held by a corporation, or

"(B) any capital interest in the partnership which provides the taxpayer with a right to share in partnership capital commensurate with—

"(i) the amount of capital contributed (determined at the time of receipt of such partnership interest), or

"(ii) the value of such interest subject to tax under section 83 upon the receipt or vesting of such interest.

"(5) THIRD PARTY INVESTOR.—The term 'third party investor' means a person who—

"(A) holds an interest in the partnership which does not constitute property held in connection with an applicable trade or business; and

"(B) is not (and has not been) actively engaged, and is (and was) not related to a person so engaged, in (directly or indirectly) providing substantial services described in paragraph (1) for such partnership or any applicable trade or business.

"(d) TRANSFER OF APPLICABLE PARTNERSHIP INTEREST TO RELATED PERSON.—

"(1) IN GENERAL.—If a taxpayer transfers any applicable partnership interest, directly or indirectly, to a person related to the taxpayer, the taxpayer shall include in gross income (as short term capital gain) the excess (if any) of—

"(A) so much of the taxpayer's long-term capital gains with respect to such interest for such taxable year attributable to the sale or ex-

change of any asset held for not more than 3 years as is allocable to such interest, over

"(B) any amount treated as short term capital gain under subsection (a) with respect to the transfer of such interest.

"(2) RELATED PERSON.—For purposes of this paragraph, a person is related to the taxpayer if—

"(A) the person is a member of the taxpayer's family within the meaning of section 318(a)(1), or

"(B) the person performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

"(e) REPORTING.—The Secretary shall require such reporting (at the time and in the manner prescribed by the Secretary) as is necessary to carry out the purposes of this section.

"(f) REGULATIONS.—The Secretary shall issue such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section".

(b) COORDINATION WITH SECTION 83.—Subsection (e) of section 83 is amended by striking "or" at the end of paragraph (4), by striking the period at the end of para-

graph (5) and inserting ", or", and by adding at the end the following new paragraph:

"(6) a transfer of an applicable partnership interest to which section 1061 applies.".

(c) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to 1061 and inserting the following new items:

"Sec. 1061. Partnership interests held in connection with performance of services.
"Sec. 1062. Cross references.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Page 309, after line 21, insert the following:

SEC. 3804. TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) IN GENERAL.—

(1) ELECTION TO DEFER INCOME.—Section 83 is amended by adding at the end the following new subsection:

"(i) QUALIFIED EQUITY GRANTS.—

"(1) IN GENERAL.—For purposes of this subtitle, if qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection—

"(A) except as provided in subparagraph (B), no amount shall be included in income under subsection (a) for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable, and

"(B) an amount equal to the amount which would be included in income of the employee under subsection (a) (determined without regard to this subsection) shall be included in income for the taxable year of the employee which includes the earliest of—

"(i) the first date such qualified stock becomes transferable (including transferable to the employer),

"(ii) the date the employee first becomes an excluded employee,

"(iii) the first date on which any stock of the corporation which issued the qualified stock becomes readily tradable on an established securities market (as determined by the Secretary, but not including any market unless such market is recognized as an established securities market

by the Secretary for purposes of a provision of this title other than this subsection),

"(iv) the date that is 5 years after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, or

"(v) the date on which the employee revokes (at such time and in such manner as the Secretary may provide) the election under this subsection with respect to such stock.

"(2) QUALIFIED STOCK.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'qualified stock' means, with respect to any qualified employee, any stock in a corporation which is the employer of such employee, if—

"(i) such stock is received—

"(I) in connection with the exercise of an option, or

"(II) in settlement of a restricted stock unit, and

"(ii) such option or restricted stock unit was provided by the corporation—

"(I) in connection with the performance of services as an employee, and

"(II) during a calendar year in which such corporation was an eligible corporation.

"(B) LIMITATION.—The term 'qualified stock' shall not include any stock if the employee may sell such stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in such stock first become transferable or not subject to a substantial risk of forfeiture.

"(C) ELIGIBLE CORPORATION.—For purposes of subparagraph (A)(ii)(II)—

"(i) IN GENERAL.—The term 'eligible corporation' means, with respect to any calendar year, any corporation if—

"(I) no stock of such corporation (or any predecessor of such corporation) is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii))

during any preceding calendar year, and

"(II) such corporation has a written plan under which, in such calendar year, not less than 80 percent of all employees who provide services to such corporation in the United States (or any possession of the United States) are granted stock options, or restricted stock units, with the same rights and privileges to receive qualified stock.

"(ii) SAME RIGHTS AND PRIVILEGES.—For purposes of clause (i)(II)—

"(I) except as provided in subclauses (II) and (III), the determination of rights and privileges with respect to stock shall be determined in a similar manner as provided under section 423(b)(5),

"(II) employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not

equal in amount, so long as the number of shares available to each employee is more than a de minimis amount, and

"(III) rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of a restricted stock unit.

"(iii) EMPLOYEE.—For purposes of clause (i)(II), the term 'employee' shall not include any employee described in section 4980E(d)(4) or any excluded employee.

"(iv) SPECIAL RULE FOR CALENDAR YEARS BEFORE 2018.—In the case of any calendar year beginning before January 1, 2018, clause (i)(II) shall be applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

"(3) QUALIFIED EMPLOYEE; EXCLUDED EMPLOYEE.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified employee' means any individual who—

"(i) is not an excluded employee, and

"(ii) agrees in the election made under this subsection to meet such requirements as determined by the Secretary to be necessary to ensure that the withholding requirements of the corporation under chapter 24 with respect to the qualified stock are met.

"(B) EXCLUDED EMPLOYEE.—The term 'excluded employee' means, with respect to any corporation, any individual—

"(i) who was a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the 10 preceding calendar years,

"(ii) who is or has been at any prior time—

"(I) the chief executive officer of such corporation or an individual acting in such a capacity, or

"(II) the chief financial officer of such corporation or an individual acting in such a capacity,

"(iii) who bears a relationship described in section 318(a)(1) to any indi-

vidual described in subclause (I) or (II) of clause (ii), or

"(iv) who has been for any of the 10 preceding taxable years one of the 4 highest compensated officers of such corporation determined with respect to each such taxable year on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

"(4) ELECTION.—

"(A) TIME FOR MAKING ELECTION.—An election with respect to qualified stock shall be made under this subsection no later than 30 days after the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).

"(B) LIMITATIONS.—No election may be made under this section with respect to any qualified stock if—

"(i) the qualified employee has made an election under subsection (b) with respect to such qualified stock,

"(ii) any stock of the corporation which issued the qualified stock is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) at any time before the election is made, or

"(iii) such corporation purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, unless—

"(I) not less than 25 percent of the total dollar amount of the stock so purchased is deferral stock, and

"(II) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

"(C) DEFINITIONS AND SPECIAL RULES RELATED TO LIMITATION ON STOCK REDEMPTIONS.—

"(i) DEFERRAL STOCK.—For purposes of this paragraph, the term 'deferral stock' means stock with respect to which an election is in effect under this subsection.

"(ii) DEFERRAL STOCK WITH RESPECT TO ANY INDIVIDUAL NOT TAKEN INTO ACCOUNT IF INDIVIDUAL HOLDS DEFERRAL STOCK WITH LONGER DEFERRAL PERIOD.—Stock purchased by a corporation from any individual shall not be treated as deferral stock for purposes of clause (iii) if such individual (immediately after such purchase) holds any deferral stock with respect to which an election has been in effect under this subsection for a longer period than the election with respect to the stock so purchased.

"(iii) PURCHASE OF ALL OUTSTANDING DEFERRAL STOCK.—The requirements of subclauses (I) and (II) of subparagraph (B)(iii) shall be treated as

met if the stock so purchased includes all of the corporation's outstanding deferral stock.

"(iv) REPORTING.—Any corporation which has outstanding deferral stock as of the beginning of any calendar year and which purchases any of its outstanding stock during such calendar year shall include on its return of tax for the taxable year in which, or with which, such calendar year ends the total dollar amount of its outstanding stock so purchased during such calendar year and such other information as the Secretary may require for purposes of administering this paragraph.

"(5) CONTROLLED GROUPS.—For purposes of this subsection, all corporations which are members of the same controlled group of corporations (as defined in section 1563(a)) shall be treated as one corporation.

"(6) NOTICE REQUIREMENT.—Any corporation that transfers qualified stock to a qualified employee shall, at the time that (or a reasonable period before) an amount attributable to such stock would

(but for this subsection) first be includible in the gross income of such employee—

“(A) certify to such employee that such stock is qualified stock, and

“(B) notify such employee—

“(i) that the employee may elect to defer income on such stock under this subsection, and

“(ii) that, if the employee makes such an election—

“(I) the amount of income recognized at the end of the deferral period will be based on the value of the stock at the time at which the rights of the employee in such stock first become transferable or not subject to substantial risk of forfeiture, notwithstanding whether the value of the stock has declined during the deferral period,

“(II) the amount of such income recognized at the end of the deferral period will be subject to withholding under section 3401(i) at the rate determined under section 3402(t), and

"(III) the responsibilities of the employee (as determined by the Secretary under paragraph (3)(A)(ii)) with respect to such withholding.".

(2) DEDUCTION BY EMPLOYER.—Subsection (h) of section 83 is amended by striking "or (d)(2)" and inserting "(d)(2), or (i)".

(b) WITHHOLDING.—

(1) TIME OF WITHHOLDING.—Section 3401 is amended by adding at the end the following new subsection:

"(i) QUALIFIED STOCK FOR WHICH AN ELECTION IS IN EFFECT UNDER SECTION 83(i).—For purposes of subsection (a), qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i) shall be treated as wages—

"(1) received on the earliest date described in section 83(i)(1)(B), and

"(2) in an amount equal to the amount included in income under section 83 for the taxable year which includes such date.".

(2) AMOUNT OF WITHHOLDING.—Section 3402 is amended by adding at the end the following new subsection:

"(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i)—

"(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

"(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.".

(c) COORDINATION WITH OTHER DEFERRED COMPENSATION RULES.—

(1) ELECTION TO APPLY DEFERRAL TO STATUTORY OPTIONS.—

(A) INCENTIVE STOCK OPTIONS.—Section 422(b) is amended by adding at the end the following: "Such term shall not include any option if an election is made under section 83(i) with respect to the stock received in connection with the exercise of such option.".

(B) EMPLOYEE STOCK PURCHASE PLANS.—Section 423(a) is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to any share of stock with respect to which an election is made under section 83(i).".

(2) EXCLUSION FROM DEFINITION OF NONQUALIFIED DEFERRED COMPENSATION PLAN.—Section 409B(b), as added by this Act, is amended by adding at the end the following new paragraph:

"(8) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan.".

(d) INFORMATION REPORTING.—Section 6051(a) is amended by striking "and" at the end of paragraph (13), by striking the period at the end of paragraph (14) and inserting a comma, and by inserting after paragraph (14) the following new paragraphs:

"(15) the amount excludable from gross income under subparagraph (A) of section 83(i)(1),

"(16) the amount includible in gross income under subparagraph (B) of section 83(i)(1) with respect to an event described in such subparagraph which occurs in such calendar year, and

"(17) the aggregate amount of income which is being deferred pursuant to elections under section

83(i), determined as of the close of the calendar year.''.

(e) Penalty for Failure of Employer To Provide Notice of Tax Consequences.—Section 6652 is amended by adding at the end the following new subsection:

``(o) Failure to Provide Notice Under Section 83(i).—In the case of each failure to provide a notice as required by section 83(i)(6), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.''.

(f) Effective Dates.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to stock attributable to options exercised, or restricted stock units settled, after December 31, 2017.

(2) Requirement to provide notice.—The amendments made by subsection (e) shall apply to failures after December 31, 2017.

(g) TRANSITION RULE.—Until such time as the Secretary (or the Secretary's delegate) issue regulations or other guidance for purposes of implementing the requirements of paragraph (2)(C)(i)(II) of section 83(i) of the Internal Revenue Code of 1986 (as added by this section), or the requirements of paragraph (6) of such section, a corporation shall be treated as being in compliance with such requirements (respectively) if such corporation complies with a reasonable good faith interpretation of such requirements.

Page 344, strike lines 9 through 12, and insert the following:

"(4) COORDINATION WITH SECTION 78.—With respect to the taxes treated as paid or accrued by a domestic corporation with respect to amounts which are includible in gross income of such domestic corporation by reason of this section, section 78 shall apply only to so much of such taxes as bears the same proportion to the amount of such taxes as—

"(A) the excess of—

"(i) the amounts which are includible in gross income of such domestic corporation by reason of this section, over

"(ii) the deduction allowable under subsection (c) with respect to such amounts, bears to

"(B) such amounts.".

Page 372, line 12, strike "subsection (h) or (i)" and insert "subsection (c)(2)(C), (h), or (i)".

Page 376, strike lines 3 through 7, and insert the following:

"(1) COMMODITIES GROSS INCOME.—The term 'commodities gross income' means, with respect to any corporation—

"(A) gross income of such corporation from the disposition of commodities which are produced or extracted by such corporation (or a partnership in which such corporation is a partner), and

"(B) gross income of such corporation from the disposition of property which gives rise to income described in subparagraph (A).".

Page 398, strike lines 7 through 10, and insert the following:

"(C) the foreign corporation shall be allowed a deduction for the taxable year referred

to in subparagraph (A) equal to the product of—

"(i) the sum of 104 percent plus the annual Federal short-term rate (determined under section 1274(d)) for the last month ending before the beginning of the taxable year, multiplied by

"(ii) the deemed expenses with respect to such amount.".

Page 398, strike lines 21 through 25, and insert the following:

"(ii) any amount paid or incurred for the acquisition of any security described in section 475(c)(2) or any commodity described in section 475(e)(2),".

Page 399, strike lines 10 through 14 and insert the following:

"(C) AMOUNTS NOT TREATED AS EFFECTIVELY CONNECTED TO EXTENT OF GROSS-BASIS TAX.—Subparagraph (B)(iii) shall only apply to so much of any specified amount as bears the proportion to such amount as—".

Page 400, line 1, insert "such specified amount and" before "deemed expenses".

Page 400, strike lines 13 through 19, and insert the following:

"(C) METHOD OF DETERMINATION.—Amounts described in subparagraph (B) shall be determined with respect to the international financial reporting group on the basis of the consolidated financial statements referred to in paragraph (4)(A)(i) and the books and records of the members of the international financial reporting group which are used in preparing such statements, taking into account only revenues and expenses of the members of such group (other than the members of such group which are treated as domestic for purposes of this subsection) derived from, or incurred with respect to—

"(i) persons who are not members of such group, and

"(ii) members of such group which are treated as a domestic corporation for purposes of this subsection.".

Page 403, strike line 20 and all that follows through page 404, line 9, and insert the following:

"(8) TREATMENT OF FOREIGN TAXES.—

"(A) ALLOWANCE OF CREDIT.—In the case of any foreign corporation which receives specified amounts to which paragraph (1) applies during any taxable year, there shall be allowed as a credit against the tax imposed by this chapter for such taxable year an amount equal to the product of—

"(i) the excess (if any) of—

"(I) the aggregate specified amounts received by such foreign corporation to which paragraph (1) applies for such taxable year, over

"(II) the aggregate amount of deductions allowed under paragraph (1)(C) with respect to such foreign corporation for such taxable year, multiplied by

"(ii) the lesser of—

"(I) 50 percent of the international financial reporting group's effective foreign tax rate for the reporting year during which or with which such taxable year ends, or

"(II) 20 percent.

"(B) DISALLOWANCE OF FOREIGN TAX CREDIT.—No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to any specified amount to which paragraph (1) applies.

"(C) DENIAL OF DEDUCTION.—No deduction shall be allowed under this chapter for any tax for which credit is not allowable under section 901 by reason of subparagraph (B) (determined by treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

"(D) EFFECTIVE FOREIGN TAX RATE.—For purposes of this paragraph, the term 'effective foreign tax rate' means, with respect to any reporting year of any international financial reporting group, the ratio (expressed as a percentage and not less than zero) of—

"(i) the foreign income taxes paid by the international financial reporting group during such reporting year, divided by

"(ii) the net income of the international financial reporting group deter-

mined without regard to interest income, interest expense, and income taxes.

Amounts described in this subparagraph shall be determined as provided in paragraph (3)(C).

"(E) FOREIGN INCOME TAXES.—For purposes of this paragraph, the term 'foreign income taxes' means any income, war profits, or excess profits taxes paid to any foreign country or possession of the United States.".

Page 418, line 12, strike "$100,000" and insert "$250,000".

Amend the long title so as to read: "A bill to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.".

☒

Re:

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">
To: "Schneider, Donald" <donald.schneider@mail.house.gov>
Date: Tue, 07 Nov 2017 12:30:11 -0500

Thank you!

From: Schneider, Donald <Donald.Schneider@mail.house.gov>
Date: November 7, 2017 at 12:20:15 PM EST
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: (No subject)

CURRENT LAW:
$59,000 AGI
-$12,700 in standard deduction
-$16,200 in 4x personal exemptions
= $30,100 taxable income
10% x $18,650 = $1,865
15% x $11,450 = $1,717.50
= $3,582.50 preliminary liability
- $2,000 in 2x child tax credits
= $1,582.50 in tax liability under current law

TAX REFORM:
b(5)
[redacted]

Donald Schneider
Donald.Schneider@mail.house.gov
Senior Economist, Committee on Ways and Means
1136 Longworth HOB
Main: 202-225-3625
Direct: 202-226-5475

Sent from my iPhone

RE:

From: "Schneider, Donald" <donald.schneider@mail.house.gov>
To: [redacted]@treasury.gov>
Date: Tue, 07 Nov 2017 13:54:25 -0500

Thanks, [redacted]

[redacted]

I'll talk to our press team and speaker's office so we can all be on the same page

From: [redacted]@treasury.gov [mailto:[redacted]@treasury.gov]
Sent: November 7, 2017 1:36 PM
To: Schneider, Donald <Donald.Schneider@mail.house.gov>
Subject: FW:

Hey Donald,

Justin suggested that I share these suggestions about your very popular $59,000 example. These are just thoughts and, of course, I don't know the context of your example.

Happy to talk,

[redacted]

From: Muzinich, Justin
Sent: Tuesday, November 07, 2017 1:30 PM
To: [redacted]@treasury.gov>
Subject: RE:

Thanks [redacted] Good points. Feel free to share directly w Donald.

From: [redacted]@treasury.gov>
Date: November 7, 2017 at 1:11:12 PM EST
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: RE:

[redacted]

b(5) [redacted]

From: Muzinich, Justin
Sent: Tuesday, November 07, 2017 12:23 PM
To: b(6) [redacted]@treasury.gov>
Subject:

b(5) [redacted]

From: Schneider, Donald <Donald.Schneider@mail.house.gov>
Date: November 7, 2017 at 12:20:15 PM EST
To: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: (No subject)

CURRENT LAW:
$59,000 AGI
-$12,700 in standard deduction
-$16,200 in 4x personal exemptions
= $30,100 taxable income
10% x $18,650 = $1,865
15% x $11,450 = $1,717.50
= $3,582.50 preliminary liability
- $2,000 in 2x child tax credits
= $1,582.50 in tax liability under current law

TAX REFORM:
b(5) [redacted]

Donald Schneider

Donald.Schneider@mail.house.gov
Senior Economist, Committee on Ways and Means
1136 Longworth HOB
Main: 202-225-3625
Direct: 202-226-5475

Sent from my iPhone

Can you take a look at this?

From: "Schneider, Donald" <donald.schneider@mail.house.gov>
To: (b) (6) [redacted]@treasury.gov>
Date: Tue, 07 Nov 2017 15:28:25 -0500
Attachments: WMC dem members tax cuts.xlsx (19.15 kB)

RE: Can you take a look at this?

From: "Schneider, Donald" <donald.schneider@mail.house.gov>
To: [redacted]@treasury.gov>
Date: Tue, 07 Nov 2017 16:32:31 -0500

So glad I sent it to you.

Thanks again

From: [redacted]@treasury.gov [mailto:[redacted]@treasury.gov]
Sent: November 7, 2017 4:23 PM
To: Schneider, Donald <Donald.Schneider@mail.house.gov>
Subject: RE: Can you take a look at this?
Importance: High

b(5) [redacted]

From: Schneider, Donald [mailto:Donald.Schneider@mail.house.gov]
Sent: Tuesday, November 07, 2017 3:28 PM
To: [redacted]@treasury.gov>
Subject: Can you take a look at this?

WMC members tax cuts_brittan.xlsx

From:	"Schneider, Donald" <donald.schneider@mail.house.gov>
To:	b(6) [redacted]@treasury.gov>
Cc:	"Sandell, John" <john.sandell@mail.house.gov>
Date:	Wed, 08 Nov 2017 08:08:30 -0500
Attachments:	WMC members tax cuts_brittan.xlsx (34.13 kB)

Fixed it. You were right.

RE: WMC members tax cuts_brittan.xlsx

From: [redacted] <"/o=ustreasury/ou=do/cn=recipients/cn=[redacted]
To: "Schneider, Donald" <donald.schneider@mail.house.gov>
Cc: "Sandell, John" <john.sandell@mail.house.gov>
Date: Wed, 08 Nov 2017 09:34:35 -0500

CTC numbers look right.

Happy to help.

From: Schneider, Donald [mailto:Donald.Schneider@mail.house.gov]
Sent: Wednesday, November 08, 2017 8:09 AM
To: [redacted]@treasury.gov>
Cc: Sandell, John <John.Sandell@mail.house.gov>
Subject: WMC members tax cuts_brittan.xlsx

Fixed it. You were right.

Simple calculator for comparing CL and HWM

From: "Bailey, Bradley" <bradley.bailey@treasury.gov>
To: "Specht, Brittan" <brittan.specht@mail.house.gov>, donald.schneider@mail.house.gov
Cc: "Dunham, Will" <will.dunham@mail.house.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>, [redacted]@treasury.gov>, [redacted]@treasury.gov>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Wed, 08 Nov 2017 10:14:23 -0500
Attachments: CL and HWM Example Calculator 11072017 FINAL.XLSX (45.97 kB)

Brittan / Donald:

In advance of our 1pm meeting, wanted to share the attached calculator that OTA has been working on. It allows the user to enter income, dependents, and deductions for each filing status (e.g., single, mfj) and from that information automatically computes tax liability. The income and deduction items can be customized for a state or congressional district using the taxpayer advocate or IRS data.

Brad

Brad Bailey
Deputy Assistant Secretary for Tax and Budget
Office of Legislative Affairs
U.S. Department of the Treasury
Bradley.bailey@treasury.gov
C: (202) 615-2125
O: [redacted]

Chairman's Final Amendment

From: "Angus, Barbara" <barbara.angus@mail.house.gov>
To: "Knight, Shahira E. EOP/WHO" <[redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Cc: "Stewart, David" <david.stewart@mail.house.gov>
Date: Thu, 09 Nov 2017 13:32:53 -0500
Attachments: Summary of Chairman's Amendment #2.pdf (113.21 kB); BRADTX_048_xml[3].pdf (93.02 kB)

Here is the Chairman's final amendment — text and summary. Very exciting!

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
1136 Longworth House Office Building
202.225.5522
barbara.angus@mail.house.gov

Summary of Chairman's Amendment #2 to the Amendment in the Nature of a Substitute
H.R. 1, *Tax Cuts and Jobs Act*

Section 1004 – Maximum rate on business income of individuals (reduced rate for small businesses with net active business income)
The amendment provides a 9-percent tax rate, in lieu of the ordinary 12-percent tax rate, for the first $75,000 in net business taxable income of an active owner or shareholder earning less than $150,000 in taxable income through a pass-through business. As taxable income exceeds $150,000, the benefit of the 9-percent rate relative to the 12-percent rate is reduced, and it is fully phased out at $225,000. Businesses of all types are eligible for the preferential 9-percent rate, and such rate applies to all business income up to the $75,000 level. The 9-percent rate is phased in over five taxable years, such that the rate for 2018 and 2019 is 11 percent, the rate for 2020 and 2021 is 10 percent, and the rate for 2022 and thereafter is 9 percent. For unmarried individuals, the $75,000 and $150,000 amounts are $37,500 and $75,000, and for heads of household, those amounts are $56,250 and $112,500.

Section 1004 – Maximum rate on business income of individuals (eliminate provisions related to Self-Employment Contributions Act)
The amendment preserves the current-law rules on the application of payroll taxes to amounts received through a pass-through entity.

Section 1102 – Repeal of nonrefundable credits
The amendment preserves the current law non-refundable credit for qualified adoption expenses.

Section 1103 – Refundable credit program integrity
The amendment requires a taxpayer to provide an SSN for the child in order to claim the entire amount of the enhanced child tax credit.

Section 1205 – Rollovers between qualified tuition programs and qualified able programs
The amendment would allow rollovers from section 529 plans to ABLE programs.

Section 1405 – Repeal of exclusion for qualified moving expense reimbursement
The amendment preserves the current law tax treatment for moving expenses in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order.

Section 3001 – Reduction in corporate tax rate
The amendment lowers the 80-percent dividends received deduction to 65 percent and the 70-percent dividends received deduction to 50 percent, preserving the current law effective tax rates on income from such dividends.

Section 3101, 3301 – Interest
The amendment provides an exclusion from the limitation on deductibility of net business interest for taxpayers that paid or accrued interest on "floor plan financing indebtedness." Full expensing would no longer be allowed for any trade or business that has floor plan financing indebtedness.

Section 3204 – Modify treatment of S corporation conversions into C corporations
The amendment provides that distributions from an eligible terminated S corporation would be treated as paid from its accumulated adjustments account and from its earnings and profits on a pro-rata basis. The amendment provides that any section 481(a) adjustment would be taken into account ratably over a 6-year period. For this purpose, an eligible terminated S corporation means any C corporation which (i) was an S corporation on the date before the enactment date, (ii) revoked its S corporation election during the 2-year period beginning on the enactment date, and (iii) had the same owners on the enactment date and on the revocation date.

Section 3315 – Amortization of Research and Experimentation Expenditures
The amendment provides that certain research or experimental expenditures are required to be capitalized and amortized over a 5-year period (15 years in the case of expenditures attributable to research conducted outside the United States). The amendment provides that this rule applies to research or experimental expenditures paid or incurred during taxable years beginning after 2023.

Section 3316 – Uniform treatment of expenses in contingent fee cases
The amendment disallows an immediate deduction for litigation costs advanced by an attorney to a client in contingent-fee litigation until the contingency is resolved, thus creating parity throughout the United States as to when, if ever, such expenses are deductible in such litigation. Under current law, certain attorneys within the Ninth Circuit who work on a contingency basis can immediately deduct expenses that ordinarily would be considered fees paid on behalf of clients, in the form of loans to those clients, and therefore not deductible when paid or incurred. This provision creates parity on this issue throughout the United States by essentially repealing the Ninth Circuit case, *Boccardo v. Commissioner*, 56 F.3d 1016 (9th Cir. 1995), which created a circuit split on this issue.

Section 3703 – Surtax on life insurance company taxable income
The amendment generally preserves current law tax treatment of insurance company deferred acquisition costs, life insurance company reserves, and pro-ration, and imposes an 8% surtax on life insurance income. This provision is intended as a placeholder.

Section 3801 – Nonqualified deferred compensation
The amendment strikes Section 3801 so that the current-law tax treatment of nonqualified deferred compensation is preserved.

Section 3805 – Modification of treatment of qualified equity grants
The amendment clarifies that restricted stock units (RSU) are not eligible for section 83(b) elections. Other than new section 83(i), section 83 does not apply to RSUs.

Section 4004 – Treatment of deferred foreign income upon transition to participation exemption system of taxation
The amendment provides for effective tax rates on deemed repatriated earnings of 7% on earnings held in illiquid assets and 14% on earnings held in liquid assets.

Section 4303 – Excise tax on certain payments from domestic corporations to related foreign corporations; election to treat such payments as effectively connected income.
The amendment modifies the bill's international base erosion rules in two respects. First, the provision eliminates the mark-up on deemed expenses. Second, the amendment expands the foreign tax credit to apply to 80% of foreign taxes and refines the measurement of foreign taxes paid by reference to section 906 of current law rather than a formula based on financial accounting information.

Section 4969 – Excise taxed based on investment income of private colleges and universities
The amendment ensures that endowment assets of a private university that are formally held by organizations related to the university, and not merely those that are directly held by the university, are subject to the 1.4-percent excise tax on net investment income.

Section 5201 – Churches permitted to make statements relating to political campaign in ordinary course of religious services and activities
This amendment ensures that all 501(c)(3) organizations will not fail to be treated as organized and operated exclusively for their respective non-profit purposes because of engagement in certain political speech, as long as the speech is in the ordinary course of the organization's business and the organization's expenses related to such speech are de minimis. This provision is effective for tax years beginning after December 31, 2018 and is sunset for tax years beginning after December 31, 2023.

AMENDMENT TO THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 1 OFFERED BY MR. BRADY OF TEXAS

Page 8, line 25, strike "subsection (b)" and insert "subsections (b) and (e)(3)".

Page 16, strike lines 6 and 7, and insert the following:

"(B) in the case of a married individual filing a separate return, an amount equal to ½ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, $1,000,000.".

Page 46, after line 3, insert the following:

"(g) REDUCED RATE FOR SMALL BUSINESSES WITH NET ACTIVE BUSINESS INCOME.—

"(1) IN GENERAL.—The tax imposed by section 1 shall be reduced by 3 percent of the excess (if any) of—

"(A) the least of—

"(i) qualified active business income,

"(ii) taxable income reduced by net capital gain (as defined in section 1(h)(11)(A)), or

"(iii) the 9-percent bracket threshold amount, over

"(B) the excess (if any) of taxable income over the applicable threshold amount.

"(2) PHASE-IN OF RATE REDUCTION.—In the case of any taxable year beginning before January 1, 2022, paragraph (1) shall be applied by substituting for '3 percent'—

"(A) in the case of any taxable year beginning after December 31, 2017, and before January 1, 2020, '1 percent', and

"(B) in the case of any taxable year beginning after December 31, 2019, and before January 1, 2022, '2 percent'.

"(3) QUALIFIED ACTIVE BUSINESS INCOME.—For purposes of this subsection, the term 'qualified active business income' means the excess (if any) of—

"(A) any net business income derived from any active business activity, over

"(B) any net business loss derived from any active business activity.

"(4) 9-PERCENT BRACKET THRESHOLD AMOUNT.—For purposes of this subsection, the term '9-percent bracket threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $75,000,

"(B) in the case of an individual who is the head of a household (as defined in section 2(b)), 3⁄4 of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, 1⁄2 of the amount in effect for the taxable year under subparagraph (A).

"(5) APPLICABLE THRESHOLD AMOUNT.—For purposes of this subsection, the term 'applicable threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $150,000,

"(B) in the case of an individual who is the head of a household (as defined in section 2(b)), 3⁄4 of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, 1⁄2 of the amount in effect for the taxable year under subparagraph (A).

"(6) ESTATES AND TRUSTS.—Paragraph (1) shall not apply to any estate or trust.

"(7) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, the dollar amounts in paragraphs (4)(A) and (5)(A) shall each be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under subsection (c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.".

Page 46, line 4, strike "(g)" and insert "(h)".

Page 46, line 17, strike "(h)" and insert "(i)".

Page 47, strike line 25, and all that follows through page 50, line 10.

Page 50, line 11, strike "(d)" and insert "(c)".

Page 50, line 15, strike "(e)" and insert "(d)".

Page 50, line 18, strike "(f)" and insert "(e)".

Page 62, line 15, strike the space before ‘‘section 1(f)(3)’’.

Page 64, after line 15, insert the following:

(38) Section 219(b)(5)(C)(i)(II) is amended by striking ‘‘section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2007’ for ‘calendar year 1992’ in subparagraph (B) thereof’’ and inserting ‘‘section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2007’ for ‘calendar year 2016’ in clause (ii) thereof’’.

(39) Section 219(g)(8)(B) is amended by striking ‘‘section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2005’ for ‘calendar year 1992’ in subparagraph (B) thereof’’ and inserting ‘‘section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2005’ for ‘calendar year 2016’ in clause (ii) thereof’’.

Page 69, strike the text between lines 14 and 15, and insert the following:

‘‘Sec. 24. Child and family tax credit.’’.

Page 72, strike lines 15 through 18.

Page 72, line 19, strike "(c)" and insert "(b)".

Page 72, line 25, strike "(d)" and insert "(c)".

Page 73, line 13, strike "(e)" and insert "(d)".

Page 73, line 18, strike "SUBSECTION (c)" and insert "SUBSECTION (b)".

Page 73, line 21, strike "SUBSECTION (d)" and insert "SUBSECTION (c)".

Page 74, strike line 2 and all that follows through page 75, line 4, and insert the following:

(a) IDENTIFICATION REQUIREMENTS FOR CHILD AND FAMILY TAX CREDIT.—

(1) IN GENERAL.—Section 24(e) is amended to read as follows:

"(e) IDENTIFICATION REQUIREMENTS.—

"(1) REQUIREMENTS FOR QUALIFYING CHILD.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the name and social security number of such qualifying child on the return of tax for the taxable year. The preceding sentence shall not prevent a qualifying child from

being treated as a dependent described in subsection (a)(2).

"(2) OTHER IDENTIFICATION REQUIREMENTS.—No credit shall be allowed under this section with respect to any individual unless the taxpayer identification number of such individual is included on the return of tax for the taxable year and such identifying number was issued before the due date for filing the return for the taxable year.

"(3) SOCIAL SECURITY NUMBER.—For purposes of this subsection, the term 'social security number' means a social security number issued by the Social Security Administration (but only if the social security number is issued to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act)).".

Page 75, starting line 10, strike "required under section 24(d)(5) (relating to refundable portion of child tax credit)".

Page 75, line 12, insert a comma after "TIN".

Page 75, strike lines 15 through 18.

Page 96, strike lines 6 through 8, and insert the following:

(c) CONFORMING AMENDMENTS RELATED TO SECTION 222.—

(1) Section 62(a) is amended by striking paragraph (18).

(2) Section 74(d)(2)(B) is amended by striking "222,".

(3) Section 86(b)(2)(A) is amended by striking "222,".

(4) Section 219(g)(3)(A)(ii) is amended by striking "222,".

Page 97, after line 15, insert the following:

(f) CONFORMING AMENDMENTS RELATED TO SECTION 135.—

(1) Section 74(d)(2)(B) is amended by striking "135,".

(2) Section 86(b)(2)(A) is amended by striking "135,".

(3) Section 219(g)(3)(A)(ii) is amended by striking "135,".

Page 97, line 16, strike "(f)" and insert "(g)".

Page 97, after line 24, insert the following:

SEC. 1205. ROLLOVERS BETWEEN QUALIFIED TUITION PROGRAMS AND QUALIFIED ABLE PROGRAMS.

(a) ROLLOVERS FROM QUALIFIED TUITION PROGRAMS TO QUALIFIED ABLE PROGRAMS.—Section 529(c)(3)(C)(i) is amended by striking "or" at the end of subclause (I), by striking the period at the end of subclause (II) and inserting ", or", and by adding at the end the following new subclause:

"(III) to an ABLE account (as defined in section 529A(e)(6)) of the designated beneficiary or a member of the family of the designated beneficiary.

Subclause (III) shall not apply to so much of a distribution which, when added to all other contributions made to the ABLE account for the taxable year, exceeds the limitation under section 529A(b)(2)(B).".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2017.

Page 101, strike lines 21 through 24 and insert the following:

(B) Section 163(h) is amended by striking subparagraphs (E) and (F) in paragraph (4).

Page 102, starting line 7, strike "Rules similar" and all that follows through "the preceding sentence." on line 9.

Page 102, starting line 19, strike ", and the second sentence of paragraph (4)(A)(i),".

Page 111, line 7, strike "table of section" and insert "table of sections".

Page 120, line 23, strike "table of section" and insert "table of sections".

Page 124, line 7, strike "table of section" and insert "table of sections".

Page 124, after line 8, insert the following:

(b) RETENTION OF MOVING EXPENSES FOR MEMBERS OF ARMED FORCES.—Section 134(b) is amended by adding at the end the following new paragraph:

"(7) MOVING EXPENSES.—The term 'qualified military benefit' includes any benefit described in section 217(g) (as in effect before the enactment of the Tax Cuts And Jobs Act).".

Page 124, line 9, strike "(b)" and insert "(c)".

Page 124, line 22, strike "(c)" and insert "(d)".

Page 137, strike lines 1 through 3.

Page 137, line 4, strike "(2)" and insert "(1)".

Page 137, line 7, strike "(as" and all that follows through "paragraph (1))" on line 8.

Page 137, line 15, strike "(3)" and insert "(2)".

Page 166, line 20, strike "2023" and insert "2024".

Page 166, line 24, strike "2023" and insert "2024".

Page 168, line 13, strike "2023" and insert "2024".

Page 168, line 23, strike "2023" and insert "2024".

Page 169, line 2, strike "2023" and insert "2024".

Page 169, line 9, strike "2023" and insert "2024".

Page 169, line 11, strike "2023" and insert "2024".

Page 170, line 11, strike "2023" and insert "2024".

Page 170, strike lines 16 through 20, and insert the following:

"(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) of such calendar year by substituting 'calendar year 2011' for 'calendar year 2016' in clause (ii) thereof.".

Page 171, line 5, strike "2023" and insert "2024".

Page 171, line 6, strike "2023" and insert "2024".

Page 171, line 12, strike "2023" and insert "2024".

Page 176, strike lines 17 through 21.

Page 190, after line 13, insert the following:

(c) REDUCTION IN DIVIDEND RECEIVED DEDUCTIONS TO REFLECT LOWER CORPORATE INCOME TAX RATES.—

(1) DIVIDENDS RECEIVED BY CORPORATIONS.—

(A) IN GENERAL.—Section 243(a)(1) is amended by striking "70 percent" and inserting "50 percent".

(B) DIVIDENDS FROM 20-PERCENT OWNED CORPORATIONS.—Section 243(c)(1) is amended—

(i) by striking "80 percent" and inserting "65 percent", and

(ii) by striking "70 percent" and inserting "50 percent".

(C) CONFORMING AMENDMENT.—The heading for section 243(c) is amended by striking "RETENTION OF 80-PERCENT DIVIDEND RECEIVED DEDUCTION" and inserting "INCREASED PERCENTAGE".

(2) DIVIDENDS RECEIVED FROM FSC.—Section 245(c)(1)(B) is amended—

(A) by striking "70 percent" and inserting "50 percent", and

(B) by striking "80 percent" and inserting "65 percent".

(3) LIMITATION ON AGGREGATE AMOUNT OF DEDUCTIONS.—Section 246(b)(3) is amended—

(A) by striking "80 percent" in subparagraph (A) and inserting "65 percent", and

(B) by striking "70 percent" in subparagraph (B) and inserting "50 percent".

(4) REDUCTION IN DEDUCTION WHERE PORTFOLIO STOCK IS DEBT-FINANCED.—Section 246A(a)(1) is amended—

(A) by striking "70 percent" and inserting "50 percent", and

(B) by striking "80 percent" and inserting "65 percent".

(5) INCOME FROM SOURCES WITHIN THE UNITED STATES.—Section 861(a)(2) is amended—

(A) by striking "100/70th" and inserting "100/50th" in subparagraph (B), and

(B) in the flush sentence at the end—

(i) by striking "100/80th" and inserting "100/65th", and

(ii) by striking "100/70th" and inserting "100/50th".

Page 190, line 14, strike "(c)" and insert "(d)".

Page 190, line 23, strike "(d)" and insert "(e)".

Page 196, strike lines 9 through 14, and insert the following:

"(G) EXCEPTION FOR PROPERTY OF CERTAIN BUSINESSES NOT SUBJECT TO LIMITATION ON INTEREST EXPENSE.—The term 'qualified property' shall not include any property used in—

"(i) a trade or business described in subparagraph (B) or (C) of section 163(j)(7), or

"(ii) a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section.".

Page 215, after line 3, insert the following:

SEC. 3204. MODIFICATION OF TREATMENT OF S CORPORATION CONVERSIONS TO C CORPORATIONS.

(a) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—Section 481 is amended by adding at the end the following new subsection:

"(d) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—

"(1) IN GENERAL.—In the case of an eligible terminated S corporation, any increase in tax under this chapter of by reason of an adjustment required by subsection (a)(2), and which is attributable to such corporation's revocation described in paragraph (2)(A)(ii), shall be taken into account ratably during the 6-taxable year period beginning with the year of change.

"(2) ELIGIBLE TERMINATED S CORPORATION.—For purposes of this subsection, the term 'eligible terminated S corporation' means any C corporation—

"(A) which—

"(i) was an S corporation on the day before the date of the enactment of the Tax Cuts and Jobs Act, and

"(ii) during the 2-year period beginning on the date of such enactment makes

a revocation of its election under section 1362(a), and

"(B) the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.".

(b) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD FROM S CORPORATION STATUS.—Section 1371 is amended by adding at the end the following new subsection:

"(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD.—In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)), the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.".

Page 215, line 15, strike "plus".

Page 215, line 17, strike the period at the end and insert ", plus".

Page 215, after line 17, insert the following:

"(C) the floor plan financing interest of such taxpayer for such taxable year.".

Page 217, line 2, after "of the partnership" insert ", reduced by floor plan financing interest,"

Page 219, after line 12, insert the following

"(9) FLOOR PLAN FINANCING INTEREST DEFINED.—For purposes of this subsection:

"(A) IN GENERAL.—The term 'floor plan financing interest' means interest paid or accrued on floor plan financing indebtedness.

"(B) FLOOR PLAN FINANCING INDEBTEDNESS.—The term 'floor plan financing indebtedness' means indebtedness—

"(i) used to finance the acquisition of motor vehicles held for sale to retail customers, and

"(ii) secured by the inventory so acquired.

"(C) MOTOR VEHICLE.—The term 'motor vehicle' means a motor vehicle that is any of the following:

"(i) An automobile.

"(ii) A truck.

"(iii) A recreational vehicle.

"(iv) A motorcycle.

"(v) A boat.

"(vi) Farm machinery or equipment.

"(vii) Construction machinery or equipment.".

Page 233, line 23, insert "219(g)(3)(A)(ii)," after "137(b)(3)(A),".

Page 248, after line 3, insert the following:

SEC. 3315. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—Section 174 is amended to read as follows:

"SEC. 174. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

"(a) IN GENERAL.—In the case of a taxpayer's specified research or experimental expenditures for any taxable year—

"(1) except as provided in paragraph (2), no deduction shall be allowed for such expenditures, and

"(2) the taxpayer shall—

"(A) charge such expenditures to capital account, and

"(B) be allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F))) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred.

"(b) SPECIFIED RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term 'specified research or experimental expenditures' means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

"(c) SPECIAL RULES.—

"(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section

167, and allowances under section 611, shall be considered as expenditures.

"(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

"(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

"(d) TREATMENT UPON DISPOSITION, RETIREMENT, OR ABANDONMENT.—If any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period during which such expenditures are allowed as an amortization deduction under this section, no deduction shall be allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction shall continue with respect to such expenditures.".

(b) CLERICAL AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by

striking the item relating to section 174 and inserting the following new item:

"Sec. 174. Amortization of research and experimental expenditures.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2022.

SEC. 3316. UNIFORM TREATMENT OF EXPENSES IN CONTINGENCY FEE CASES.

(a) IN GENERAL.—Section 162 is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

"(q) EXPENSES IN CONTINGENCY FEE CASES.—No deduction shall be allowed under subsection (a) to a taxpayer for any expense—

"(1) paid or incurred in the course of the trade or business of practicing law, and

"(2) resulting from a case for which the taxpayer is compensated primarily on a contingent basis,

until such time as such contingency is resolved.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenses and costs paid or incurred in taxable years beginning after the date of the enactment of this Act.

Page 280, strike line 1, and all that follows through page 285, line 4, and insert the following:

SEC. 3703. SURTAX ON LIFE INSURANCE COMPANY TAXABLE INCOME.

(a) IN GENERAL.—Section 801(a)(1) is amended—

(1) by striking "consist of a tax" and insert "consist of the sum of—

"(A) a tax", and

(2) by striking the period at the end and inserting ", and", and

(3) by adding at the end the following new subparagraph:

"(B) a tax equal to 8 percent of the life insurance company taxable income.".

Page 286, strike lines 4 through 25.

Page 292, strike line 12 and all that follows through page 293, line 9.

Page 293, strike line 11, and all that follows through page 301, line 10.

Page 303, line 3, insert "or principal financial officer" after "principal executive officer".

Page 309, after line 21, insert the following:

SEC. 3805. MODIFICATION OF TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) Section 83(i) of the Internal Revenue Code of 1986, as added by section 3804, is amended by adding at the end the following new paragraph:

"(7) RESTRICTED STOCK UNITS.—This section (other than this subsection), including any election under subsection (b), shall not apply to restricted stock units.".

(a) Section 3804(c)(2) of this Act is amended to read as follows:

"(2) EXCLUSION FROM DEFINITION OF NON-QUALIFIED DEFERRED COMPENSATION PLAN.—Subsection (d) of section 409A is amended by adding at the end the following new paragraph:

"'(7) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan solely because of an employee's election, or ability to make an election, to defer recognition of income under section 83(i).'.".

(b) The amendments made by this section shall take effect as if included in the provisions of section 3804 of this Act to which they relate.

Page 330, line 19, strike "5" and insert "7".

Page 331, line 4, strike "12" and insert "14".

Page 331, line 9, strike "5" and insert "7".

Page 331, line 9, strike "12" and insert "14".

Page 331, line 11, strike "5" and insert "7".

Page 331, line 12, strike "5" and insert "7".

Page 331, line 17, strike "5" and insert "7".

Page 332, line 6, strike "12" and insert "14".

Page 332, line 7, strike "12" and insert "14".

Page 332, line 11, strike "12" and insert "14".

Page 332, line 12, strike "5" and insert "7".

Page 343, line 17, strike "85.7" and insert "80".

Page 343, line 23, strike "65.7" and insert "60".

Page 354, line 1, strike "section" and insert "sections".

Page 397, strike line 9 and all that follows through page 398, line 10, and insert the following:

"(1) IN GENERAL.—In the case of any specified amount paid or incurred by a domestic corporation to a foreign corporation which is a member of the

same international financial reporting group as such domestic corporation and which has elected to be subject to the provisions of this subsection—

"(A) such amount shall be taken into account (other than for purposes of sections 245, 245A, and 881) as if—

"(i) such foreign corporation were engaged in a trade or business within the United States,

"(ii) such foreign corporation had a permanent establishment in the United States during the taxable year, and

"(iii) such payment were effectively connected with the conduct of a trade or business within the United States and were attributable to such permanent establishment,

"(B) for purposes of subsection (c)(1)(A), no deduction shall be allowed with respect to such amount and such subsection shall be applied without regard to such amount, and

"(C) there shall be allowed as a deduction the deemed expenses with respect such amount.".

Page 403, strike line 20 and all that follows through page 404, line 18, and insert the following:

"(8) FOREIGN TAX CREDIT ALLOWED.—The credit allowed under section 906(a) with respect to amounts taken into account in income under paragraph (1)(A) shall be limited to 80 percent of the amount of taxes paid or accrued and determined without regard to section 906(b)(1).

"(9) ELECTION.—Any election under paragraph (1)—

"(A) shall be made at such time and in such form and manner as the Secretary may provide, and

"(B) shall apply for the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.".

Page 410, after line 20, insert the following:

(b) TREATMENT OF CERTAIN REFERENCES.—Section 119(e) of division A of the Tax Relief and Health Care Act of 2006 is amended by adding at the end the following: "References in this subsection to section 199 of the Internal Revenue Code of 1986 shall be treated as

references to such section as in effect before its repeal by the Tax Cuts and Jobs Act.''.

Page 410, line 21, strike ''(b)'' and insert ''(c)''.

Page 418, after line 22, insert the following:

''(d) ASSETS AND NET INVESTMENT INCOME OF RELATED ORGANIZATIONS.—

''(1) IN GENERAL.—For purposes of subsections (b)(1)(C) and (c), the assets and net investment income of any related organization shall be treated as the assets and net investment income of the eligible educational institution.

''(2) RELATED ORGANIZATION.—For purposes of this subsection, the term 'related organization' means, with respect to an eligible educational institution, any organization which—

''(A) controls, or is controlled by, such institution,

''(B) is controlled by one or more persons that control such institution, or

''(C) is a supported organization (as defined in section 509(f)(3)), or an organization described in section 509(a)(3), during the taxable year with respect to such institution.''.

Page 423, line 3, strike "**CHURCHES**" and insert "**501(c)(3) ORGANIZATIONS**".

Page 423, line 5, strike "**RELIGIOUS SERVICES AND**".

Page 423, starting line 10, strike "Churches, Integrated Auxiliaries, etc" and insert "Organizations Described in Subsection (c)(3)".

Page 423, starting line 14, strike "described in section 508(c)(1)(A)".

Page 423, line 16, strike "religious purpose" and insert "purpose described in subsection (c)(3)".

Page 423, starting line 20, strike "content of any homily, sermon" and all that follows through "such content" on line 23, and insert "content of any statement which".

Page 424, line 1, strike "is in" and insert "is made in".

Page 424, after line 6, insert the following:

"(2) Termination.—Paragraph (1) shall not apply to taxable years beginning after December 31, 2023.".

Page 424, starting line 8, strike "ending after the date of the enactment of this Act" and insert "beginning after December 31, 2018".

RE: Summary of Senate Tax bill

From: "Alety, Saat (Scott)" <saat_alety@scott.senate.gov>
To: "Alety, Saat (Scott)" <saat_alety@scott.senate.gov>
Date: Thu, 09 Nov 2017 15:46:00 -0500
Attachments: 11.9.17 Senate Tax Reform Summary.pdf (130.35 kB)

Actual PDF attached.

From: Alety, Saat (Scott)
Sent: Thursday, November 9, 2017 3:21 PM
To: Alety, Saat (Scott) <Saat_Alety@scott.senate.gov>
Subject: Summary of Senate Tax bill

Past embargo.

Saat Alety
Legislative Assistant
U.S. Senator Tim Scott (R-SC)
717 Hart Senate Office Building | Washington, DC 20510
202-224-6121 | saat_alety@scott.senate.gov

TAX CUTS & JOBS ACT

United States Senate
COMMITTEE ON FINANCE

Policy Highlights

The Tax Cuts and Jobs Act provides fiscally responsible middle-class tax relief by cutting tax rates across the board, reducing the tax burden on American job creators and modernizing our tax system. Under this proposal, a typical family of four earning the median family income (around $73,000) will see its taxes cut by nearly $1,500. The bill will also reduce the tax burden on small businesses and put American companies on a level playing field with their foreign competitors in order to grow the economy and create more jobs here at home.

Combined, all of this will mean bigger paychecks for middle-class workers and families, more American jobs and a stronger U.S. economy.

RELIEF FOR AMERICAN WORKERS AND FAMILIES

The Tax Cuts and Jobs Act:

- Lowers individual tax rates for low- and middle-income Americans by effectively expanding the zero tax bracket and maintaining a 10 percent bracket, allowing hardworking taxpayers to keep more of their hard-earned money, make ends meet, and save for retirement. The bill includes a reformed rate structure that targets tax relief to the middle class while maintaining the existing tax distribution, and a 38.5 percent bracket for high-income earners.

- Nearly doubles the standard deduction to reduce or eliminate the federal income tax burden for tens of millions of American families. The standard deduction will increase from $6,350 to $12,000 for individuals and from $12,700 to $24,000 for married couples. For single parents, the standard deduction will increase from $9,300 to $18,000.

- Recognizes the unique challenges faced by parents with young children by:
    - Expanding the child tax credit from $1,000 to $1,650 and allowing many more parents to claim the credit by substantially lifting existing caps;
    - Preserving the child and dependent care tax credit to help working parents care for their children and older dependents – such as an aging grandparent – who need support;
    - Preserving the adoption tax credit to help families with the high costs of adopting children; and
    - Allowing parents to more effectively save for the education costs of unborn children.

- Preserves the deduction for charitable contributions, continuing a long recognition of the importance of private philanthropy for the churches and community organizations that daily provide aid and assistance to those in need.

- Protects the home mortgage interest deduction for existing mortgages and maintains the deduction for newly purchased homes up to $1 million. This incentive for homeownership provides tax relief to current and aspiring homeowners.

- Continues popular retirement savings programs such as 401(k)s and Individual Retirement Accounts, to help Americans build their retirement nest eggs and prepare for the future.

RELIEF FOR AMERICAN WORKERS AND FAMILIES (continued)

- Preserves the earned income tax credit to provide tax relief to low-income Americans working to build better lives for themselves.

- Preserves additional important elements of the existing individual tax system, including:
  - Deduction for medical expenses
  - Enhanced standard deduction for the blind and elderly
  - Education relief for graduate students

- Repeals the alternative minimum tax (AMT) to simplify the tax code and eliminate uncertainty for millions of Americans who are required to calculate their taxes twice each year.

- Provides relief from the death tax by doubling the current exemption. This will reduce uncertainty and costs for family-owned farms and businesses by making it less likely that Washington will impose an unnecessary layer of taxation on Americans who want to pass on their life's work to the next generation.

RELIEF FOR JOB CREATORS OF ALL SIZES

- Permanently lowers the corporate tax rate to 20 percent so American companies no longer have to face the highest tax rate in the industrialized world, which will allow them to better compete in the global marketplace, create more jobs and increase wages.

- Substantially lowers the tax burden on Main Street job creators through:
  - A simple and easy-to-administer deduction for pass-through businesses of all sizes, allowing more small businesses to grow, invest, hire new workers and increase wages while also preventing abuse of the reformed system;
  - Enhanced Section 179 expensing to promote business investment and growth; and
  - Enhanced cash accounting, allowing more businesses to use the simple cash-basis accounting method.

- Full and immediate expensing of new equipment, which encourages growth and increases investment, productivity and wages.

- Protects the ability of small businesses to deduct interest on loans that allows Main Street employers to expand, invest, and hire new workers.

- Preserves important elements of the existing business tax system, including:
  - Low-income housing credit to continue encouraging businesses to invest in affordable housing and provide individuals and families with expanded opportunities.
  - Research and development tax credit, which enhances investments in American products, technology and innovations.

- Permanently modernizes our outdated international tax system by eliminating the antiquated "worldwide" system, in order to eliminate double taxation, enhance the competitiveness of American companies, and bring business and investment back to the United States.

- Eliminates the "lock-out effect" by making it simpler and less onerous for American multinationals to bring foreign earnings back to America for investment and growth here at home.

- Makes the United States a better place to do business by eliminating incentives for companies to shift jobs, profits and intellectual property overseas, and by creating incentives for companies to both locate in America and bring economic activity back to America.

SFC Chairman's Mark and Revenue Table

From: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>

To: "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>, "Knight, Shahira E. EOP/WHO" <[redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>

Cc: "Khosla, Jay (Finance)" <jay_khosla@finance.senate.gov>, "Hickman, Bryan (Finance)" <bryan_hickman@finance.senate.gov>, "Niederee, Katie (Finance)" <katie_niederee@finance.senate.gov>, "Lawless, Julia (Finance)" <julia_lawless@finance.senate.gov>

Date: Thu, 09 Nov 2017 20:19:45 -0500

Attachments: JCX-51-17 SFC Markup 11-9.pdf (898.53 kB); JCX5217.pdf (34.12 kB)

FYI..

Please hold tight for 30 minutes. We want to send to SFC member offices first per committee protocol. Thanks.

DESCRIPTION OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
on November 13, 2017

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

November 9, 2017
JCX-51-17

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on November 13, 2017, of an original bill, the "Tax Cuts and Jobs Act," which provides for reconciliation pursuant to section 2001 of the concurrent resolution on the budget for fiscal year 2018. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's Mark of the "Tax Cuts and Jobs Act."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of the "Tax Cuts and Jobs Act"* (JCX-51-17), November 9, 2017. This document can be found also on the Joint Committee on Taxation website at www.jct.gov. All section references herein are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

I. TAX REFORM FOR INDIVIDUALS

A. Simplification and Reform of Rates, Standard Deductions, and Exemptions

1. Reduction and simplification of individual income tax rates and modification of inflation adjustment

Present Law

In general

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. For 2017, the regular individual income tax rate schedules are as follows:

Table 1.–Federal Individual Income Tax Rates for 2017[1]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $9,325	10% of the taxable income
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325
Over $37,950 but not over $91,900	$5,226.25 plus 25% of the excess over $37,950
Over $91,900 but not over $191,650	$18,713.75 plus 28% of the excess over $91,900
Over $191,650 but not over $416,700	$46,643.75 plus 33% of the excess over $191,650
Over $416,700 but not over $418,400	$120,910.25 plus 35% of the excess over $416,700
Over $418,400	$121,505.25 plus 39.6% of the excess over $418,400
Heads of Households	
Not over $13,350	10% of the taxable income
Over $13,350 but not over $50,800	$1,335 plus 15% of the excess over $13,350
Over $50,800 but not over $131,200	$6,952.50 plus 25% of the excess over $50,800
Over $131,200 but not over $212,500	$27,052.50 plus 28% of the excess over $131,200
Over $212,500 but not over $416,700	$49,816.50 plus 33% of the excess over $212,500
Over $416,700 but not over $444,550	$117,202.50 plus 35% of the excess over $416,700
Over $444,550	$126,950 plus 39.6% of the excess over $444,550

If taxable income is:	Then income tax equals:
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $18,650	10% of the taxable income
Over $18,650 but not over $75,900	$1,865 plus 15% of the excess over $18,650
Over $75,900 but not over $153,100	$10,452.50 plus 25% of the excess over $75,900
Over $153,100 but not over $233,350	$29,752.50 plus 28% of the excess over $153,100
Over $233,350 but not over $416,700	$52,222.50 plus 33% of the excess over $233,350
Over $416,700 but not over $470,700	$112,728 plus 35% of the excess over $416,700
Over $470,700	$131,628 plus 39.6% of the excess over $470,700
Married Individuals Filing Separate Returns	
Not over $9,325	10% of the taxable income
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325
Over $37,950 but not over $76,550	$5,226.25 plus 25% of the excess over $37,950
Over $76,550 but not over $116,675	$14,876.25 plus 28% of the excess over $76,550
Over $116,675 but not over $208,350	$26,111.25 plus 33% of the excess over $116,675
Over $208,350 but not over $235,350	$56,364 plus 35% of the excess over $208,350
Over $235,350	$65,814 plus 39.6% of the excess over $235,350
Estates and Trusts	
Not over $2,550	15% of the taxable income
Over $2,550 but not over $6,000	$382.50 plus 25% of the excess over $2,550
Over $6,000 but not over $9,150	$1,245 plus 28% of the excess over $6,000
Over $9,150 but not over $12,500	$2,127 plus 33% of the excess over $9,150
Over $12,500	$3,232.50 plus 39.6% of the excess over $12,500

[1] Rev. Proc. 2016-55, 2016-45 I.R.B. 707, sec. 3.01.

Unearned income of children

Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children.[2] Generally, the kiddie tax applies to a child if: (1) the child has not reached the age of 19 by the close of the taxable year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time; (2) the child's unearned income exceeds

[2] Sec. 1(g). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

$2,100 (for 2017); and (3) the child does not file a joint return.[3] The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents. For children above age 17, the kiddie tax applies only to children whose earned income does not exceed one-half of the amount of their support.

Under these rules, the net unearned income of a child (for 2017, unearned income over $2,100) is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of the child.[4] The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2017), less the child's standard deduction) is taxed at the child's rates, regardless of whether the kiddie tax applies to the child. For these purposes, unearned income is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered, and distributions from qualified disability trusts.[5] In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.[6]

The kiddie tax is calculated by computing the "allocable parental tax." This involves adding the net unearned income of the child to the parent's income and then applying the parent's tax rate. A child's "net unearned income" is the child's unearned income less the sum of (1) the minimum standard deduction allowed to dependents ($1,050 for 2017[7]), and (2) the greater of (a) such minimum standard deduction amount or (b) the amount of allowable itemized deductions that are directly connected with the production of the unearned income.[8]

The allocable parental tax equals the hypothetical increase in tax to the parent that results from adding the child's net unearned income to the parent's taxable income.[9] If the child has net capital gains or qualified dividends, these items are allocated to the parent's hypothetical taxable income according to the ratio of net unearned income to the child's total unearned income. If a parent has more than one child subject to the kiddie tax, the net unearned income of all children is combined, and a single kiddie tax is calculated. Each child is then allocated a proportionate share of the hypothetical increase, based upon the child's net unearned income relative to the aggregate net unearned income of all of the parent's children subject to the tax.

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[3] Sec. 1(g)(2).

[4] Special rules apply for determining which parent's rate applies where a joint return is not filed.

[5] Sec. 1(g)(4) and sec. 911(d)(2).

[6] Sec. 1(h).

[7] Sec. 3.02 of Rev. Proc. 2016-55, *supra*.

[8] Sec. 1(g)(4).

[9] Sec. 1(g)(3).

Generally, a child must file a separate return to report his or her income.[10] In such case, items on the parents' return are not affected by the child's income, and the total tax due from the child is the greater of:

1. The sum of (a) the tax payable by the child on the child's earned income and unearned income up to $2,100 (for 2017), plus (b) the allocable parental tax on the child's unearned income, or

2. The tax on the child's income without regard to the kiddie tax provisions.[11]

Under certain circumstances, a parent may elect to report a child's unearned income on the parent's return.[12]

Indexing tax provisions for inflation

Under present law, many parameters of the tax system are adjusted for inflation to protect taxpayers from the effects of rising prices. Most of the adjustments are based on annual changes in the level of the Consumer Price Index for all Urban Consumers ("CPI-U").[13] The CPI-U is an index that measures prices paid by typical urban consumers on a broad range of products, and is developed and published by the Department of Labor.

Among the inflation-indexed tax parameters are the following individual income tax amounts: (1) the regular income tax brackets; (2) the basic standard deduction; (3) the additional standard deduction for aged and blind; (4) the personal exemption amount; (5) the thresholds for the overall limitation on itemized deductions and the personal exemption phase-out; (6) the phase-in and phase-out thresholds of the earned income credit; (7) IRA contribution limits and deductible amounts; and (8) the saver's credit

Capital gains rates

In general

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-percent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15-percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section

[10] Sec. 1(g)(6). See Form 8615, Tax for Certain Children Who Have Unearned Income.

[11] Sec. 1(g)(1).

[12] Sec. 1(g)(7).

[13] Sec. 1(f)(5).

1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

Definitions

Net capital gain

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Adjusted net capital gain

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

Qualified dividend income

Adjusted net capital gain is increased by the amount of qualified dividend income.

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits. Qualified dividends generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be

satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of qualified dividend income that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

Dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities are not qualified dividend income.

<u>28-percent rate gain</u>

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not

apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

Unrecaptured section 1250 gain

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

Description of Proposal

Modification of rates

The proposal replaces the individual income tax rate structure with a new rate structure.

Table 2.–Proposed Federal Individual Income Tax Rates for 2018

If taxable income is:	Then income tax equals:
	Single Individuals
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $60,000	$4,453.50 plus 22.5% of the excess over $38,700
Over $60,000 but not over $170,000	$9,246 plus 25% of the excess over $60,000
Over $170,000 but not over $200,000	$36,746 plus 32.5% of the excess over $170,000
Over $200,000 but not over $500,000	$46,496 plus 35% of the excess over $200,000
Over $500,000	$151,496 plus 38.5% of the excess over $500,000
	Heads of Households
Not over $13,600	10% of the taxable income
Over $13,600 but not over $51,800	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $60,000	$5,944 plus 22.5% of the excess over $51,800
Over $60,000 but not over $170,000	$7,789 plus 25% of the excess over $60,000
Over $170,000 but not over $200,000	$35,289 plus 32.5% of the excess over $170,000
Over $200,000 but not over $500,000	$45,039 plus 35% of the excess over $200,000
Over $500,000	$150,039 plus 38.5% of the excess over $500,000

If taxable income is:	Then income tax equals:
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $120,000	$8,907 plus 22.5% of the excess over $77,400
Over $120,000 but not over $290,000	$18,492 plus 25% of the excess over $120,000
Over $290,000 but not over $390,000	$60,992 plus 32.5% of the excess over $290,000
Over $390,000 but not over $1,000,000	$93,492 plus 35% of the excess over $390,000
Over $1,000,000	$306,992 plus 38.5% of the excess over $1,000,000
Married Individuals Filing Separate Returns	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $60,000	$4,453.50 plus 22.5% of the excess over $38,700
Over $60,000 but not over $145,000	$9,246 plus 25% of the excess over $60,000
Over $145,000 but not over $195,000	$30,496 plus 32.5% of the excess over $145,000
Over $195,000 but not over $500,000	$46,746 plus 35% of the excess over $195,000
Over $500,000	$153,496 plus 38.5% of the excess over $500,000
Estates and Trusts	
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 25% of the excess over $2,550
Over $9,150 but not over $12,500	$1,905 plus 35% of the excess over $9,150
Over $12,500	$3,077.50 plus 38.5% of the excess over $12,500

The bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of $100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

Simplification of tax on unearned income of children

The proposal simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Thus, taxable income attributable to earned income is taxed according to an unmarried taxpayers' brackets and rates. Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at

preferential rates. The child's tax is no longer affected by the tax situation of the child's parent or the unearned income of any siblings.

Replacing CPI-U with chained CPI-U

The proposal requires the use of the chained CPI-U ("C-CPI-U") to index tax parameters currently indexed by the CPI-U. The C-CPI-U is also developed and published by the Department of Labor, and differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. Values that are reset for 2018, such as the bracket thresholds and standard deduction, are indexed by the C-CPI-U in taxable years beginning after December 31, 2018. Other indexed values in the code switch from CPI-U indexing to C-CPI-U indexing going forward in taxable years beginning after December 31, 2017.

Maximum rates on capital gains and qualified dividends

The proposal generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates ("15-percent breakpoint") and the 15- and 20-percent rates ("20-percent breakpoint") are the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C-CPI-U in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is $77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for estates and trusts, and $38,600 for other unmarried individuals. The 20-percent breakpoint is $479,000 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint, such gain is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under present law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

Paid preparer due diligence requirement for head of household status

The proposal directs the Secretary of the Treasury to promulgate due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household. A penalty of $500 is imposed for each failure to meet these requirements.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Increase in standard deduction

Present Law

Under present law, an individual who does not elect to itemize deductions may reduce his adjusted gross income ("AGI") by the amount of the applicable standard deduction in arriving at his taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the basic standard deduction is $6,350 for single individuals and married individuals filing separate returns, $9,350 for heads of households, and $12,700 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[14] The amount of the standard deduction is indexed annually for inflation.

In the case of a dependent for whom a deduction for a personal exemption is allowed to another taxpayer, the standard deduction may not exceed the greater of (i) $1,050 (in 2017) or (ii) the sum of $350 (in 2017) plus the individual's earned income.

Description of Proposal

The proposal increases the basic standard deduction for individuals across all filing statuses. Under the proposal, the amount of the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers. The amount of the standard deduction is indexed for inflation using the chained consumer price index for all-urban consumers for taxable years beginning after December 31, 2018.

The additional standard deduction for the elderly and the blind is not changed by the proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Repeal of the deduction for personal exemptions

Present Law

Under present law, in determining taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2017, the amount deductible for each personal exemption is $4,050. This amount is indexed annually for inflation. The personal exemption amount is

[14] For 2017, the additional amount is $1,250 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,550. An individual who qualifies as both blind and elderly is entitled to two additional standard deductions, for a total additional amount (for 2017) of $2,500 or $3,100, as applicable.

phased out in the case of an individual with AGI in excess of $313,800 for taxpayers filing jointly, $287,650 for heads of household and $261,500 for all other filers. In addition, no personal exemption is allowed in the case of a dependent if a deduction is allowed to another taxpayer.

Withholding rules

Under present law, the amount of tax required to be withheld by employers from a taxpayer's wages is based in part on the number of withholding exemptions a taxpayer claims on his Form W-4. An employee is entitled to the following exemptions: (1) an exemption for himself, unless he allowed to be claimed as a dependent of another person; (2) an exemption to which the employee's spouse would be entitled, if that spouse does not file a Form W-4 for that taxable year claiming an exemption described in (1); (3) an exemption for each individual who is a dependent (but only if the employee's spouse has not also claimed such a withholding exemption on a Form W-4); (4) additional withholding allowances (taking into account estimated itemized deductions, estimated tax credits, and additional deductions as provided by the Secretary of the Treasury); and (5) a standard deduction allowance.

Filing requirements

Under present law, an unmarried individual is required to file a tax return for the taxable year if in that year the individual had income which equals or exceeds the exemption amount plus the standard deduction applicable to such individual (*i.e.*, single, head of household, or surviving spouse). An individual entitled to file a joint return is required to do so unless that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is less than the sum of twice the exemption amount plus the basic standard deduction applicable to a joint return, provided that such individual and his spouse, at the close of the taxable year, had the same household as their home.

Trusts and estates

In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600. A trust is allowed a deduction of $100; $300 if required to distribute all its income currently; and an amount equal to the personal exemption of an individual in the case of a qualified disability trust.

Description of Proposal

The proposal repeals the deduction for personal exemptions.

The proposal modifies the requirements for those who are required to file a tax return. In the case of an individual who is not married, such individual is required to file a tax return if the taxpayer's gross income for the taxable year exceeds the applicable standard deduction. Married individuals are required to file a return if that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is more than the standard deduction applicable to a joint return, provided that: (i) such individual and his spouse, at the close of the taxable year, had the same household as their home; (ii) the individual's spouse does not make a separate return; and (iii) neither the individual nor his spouse is a dependent of

another taxpayer who has income (other than earned income) in excess of $500 (indexed for inflation).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

B. Treatment of Business Income of Individuals

1. Allow 17.4-percent deduction to certain pass-through income

Present Law

Individual income tax rates

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status (*i.e*, single, head of household, married filing jointly, or married filing separately). For 2017, the regular individual income tax rate schedule provides rates of 10, 15, 25, 28, 33, 35, and 39.6 percent.

Partnerships

Partnerships generally are treated for Federal income tax purposes as pass-through entities not subject to tax at the entity level.[15] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account by the partners in computing their income tax liability (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).[16] A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.[17] Losses not allowed as a result of that limitation generally are carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) the partner's capital contributions to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) the partner's distributive share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any partnership distributions to the partner.[18] Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.[19]

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[15] Sec. 701.

[16] Sec. 702(a).

[17] Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely-held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

[18] Sec. 705.

[19] Sec. 731. Gain or loss may nevertheless be recognized, for example, on the distribution of money or marketable securities, distributions with respect to contributed property, or in the case of disproportionate distributions (which can result in ordinary income).

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.[20] In general, an allocation has substantial economic effect to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation and the allocation substantially affects the dollar amounts to be received by the partners from the partnership independent of tax consequences.[21]

State laws of every State provide for limited liability companies[22] ("LLCs"), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.[23]

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.[24] For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).[25]

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[26]

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[20] Sec. 704(b)(2).

[21] Treas. Reg. sec. 1.704-1(b)(2).

[22] The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

[23] Under Treasury regulations promulgated in 1996, any domestic nonpublicly traded unincorporated entity with two or more members generally is treated as a partnership for federal income tax purposes, while any single-member domestic unincorporated entity generally is treated as disregarded for Federal income tax purposes (*i.e.*, treated as not separate from its owner). Instead of the applicable default treatment, however, an LLC may elect to be treated as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701-3. These are known as the "check-the-box" regulations.

[24] Sec. 7704(a).

[25] Sec. 7704(b).

[26] Sec. 7704(c)(2). Qualifying income is defined to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Sec. 7704(d). Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts. However, the exception for partnerships with qualifying income does not apply to any partnership resembling a mutual fund (*i.e.*, that would be described in section 851(a) if it were a domestic

S corporations

For Federal income tax purposes, an S corporation[27] generally is not subject to tax at the corporate level.[28] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account by the S corporation shareholders in computing their income tax liabilities (based on the S corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in its S corporation stock and the indebtedness of the S corporation to such shareholder. Losses not allowed as a result of that limitation generally are carried forward to the next year. A shareholder's adjusted basis in the S corporation stock generally equals the sum of (1) the shareholder's capital contributions to the S corporation and (2) the shareholder's pro rata share of S corporation income, less (1) the shareholder's pro rata share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any S corporation distributions to the shareholder.[29]

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation.

Electing S corporation status

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.[30] Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation.

Sole proprietorships

Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax

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corporation), which includes a corporation registered under the Investment Company Act of 1940 (Pub. L. No. 76-768 (1940)) as a management company or unit investment trust (sec. 7704(c)(3)).

[27] An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

[28] Secs. 1363 and 1366.

[29] Sec. 1367. If any amount that would reduce the adjusted basis of a shareholder's S corporation stock exceeds the amount that would reduce that basis to zero, the excess is applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. If, after a reduction in the basis of such indebtedness, there is an event that would increase the adjusted basis of the shareholder's S corporation stock, such increase is instead first applied to restore the reduction in the basis of the shareholder's indebtedness. Sec. 1367(b)(2).

[30] Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

purposes.[31] Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,[32] for certain excise taxes,[33] and certain information reporting requirements.[34]

Description of Proposal

An individual taxpayer generally may deduct 17.4 percent of domestic qualified business income from a partnership, S corporation, or sole proprietorship.

The deduction does not apply to specified service businesses, except in the case of a taxpayer whose taxable income does not exceed $150,000 (for married individuals filing jointly; $75,000 for other individuals). The benefit of the deduction for service providers is phased out over a $50,000 range (for married individuals filing jointly; $25,000 for other individuals). The phaseout applies for taxable income exceeding $150,000 (for married individuals filing jointly; $75,000 for other individuals).

In the case of a taxpayer who has qualified business income from a partnership or S corporation, the amount of the deduction is limited to 50 percent of the W-2 wages of the taxpayer. W-2 wages of a person is the sum of wages subject to wage withholding, elective deferrals, and deferred compensation paid by the person during the calendar year ending during the taxable year. Only those wages that are properly allocable to qualified business income are taken into account.

Qualified business income for a taxable year means the net amount of domestic qualified items of income, gain, deduction, and loss with respect to the taxpayer's qualified businesses (that is, any trade or business other than specified service trades or businesses, defined below). The determination of qualified items of income, gain, deduction, and loss takes into account these items only to the extent included or allowed in the determination of taxable income for the year. For example, if in a taxable year, a qualified business has 100 of ordinary income from inventory sales, and makes an expenditure of 25 that is required to be capitalized and amortized over 5 years under applicable tax rules, the net business income is 100 minus 5 (current-year ordinary amortization deduction), or 95. The qualified business income is not reduced by the

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[31] A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701-3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

[32] Treas. Reg. sec. 301.7701-2(c)(2)(iv).

[33] Treas. Reg. sec. 301.7701-2(c)(2)(v).

[34] Treas. Reg. sec. 301.7701-2(c)(2)(vi).

entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Dividends from a real estate investment trust (other than any portion that is a capital gain dividend) are qualified items of income for this purpose. Similarly, dividends that are includable in gross income from certain cooperative are qualified items of income for this purpose.

If the amount of qualified business income is less than zero for a taxable year, *i.e.*, is a loss, the amount of the loss is treated as a loss from qualified businesses in the next taxable year.

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any amount allocated or distributed by a partnership to a partner who is acting other than in his or her capacity as a partner for services, and does not include any amount that is a guaranteed payment for services actually rendered to or on behalf of a partnership to the extent that the payment is in the nature of remuneration for those services.

Qualified business income or loss does not include certain investment-related income, gain, deductions, or loss.

A specified service trade or business means any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Limitation on losses for taxpayers other than corporations

Present Law

Loss limitation rules applicable to individuals

Passive loss rules

The passive loss rules limit deductions and credits from passive trade or business activities.[35] The passive loss rules apply to individuals, estates and trusts, and closely held corporations. A passive activity for this purpose is a trade or business activity in which the taxpayer owns an interest, but in which the taxpayer does not materially participate. A taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the

[35] Sec. 469.

operation of the activity on a basis that is regular, continuous, and substantial.[36] Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person.

Excess farm loss rules

A limitation on excess farm losses applies to taxpayers other than C corporations.[37] If a taxpayer other than a C corporation receives an applicable subsidy for the taxable year, the amount of the excess farm loss is not allowed for the taxable year, and is carried forward and treated as a deduction attributable to farming businesses in the next taxable year. An excess farm loss for a taxable year means the excess of aggregate deductions that are attributable to farming businesses over the sum of aggregate gross income or gain attributable to farming businesses plus the threshold amount. The threshold amount is the greater of (1) $300,000 ($150,000 for married individuals filing separately), or (2) for the five-consecutive-year period preceding the taxable year, the excess of the aggregate gross income or gain attributable to the taxpayer's farming businesses over the aggregate deductions attributable to the taxpayer's farming businesses.

Description of Proposal

The proposal expands the limitation on excess farm losses. Under the proposal, excess business losses of a taxpayer other than a C corporation are not allowed for the taxable year. Such losses are carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent taxable years. NOL carryovers are allowed for a taxable year up to the lesser of the carryover amount or 90 percent of taxable income determined without regard to the deduction for NOLs.

An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The threshold amount for a taxable year is $500,000 for married individuals filing jointly, and $250,000 for other individuals. The $500,000 and $250,000 thresholds are indexed for inflation.

In the case of a partnership or S corporation, the proposal applies at the partner or shareholder level. Each partner's or S corporation shareholder's share of items of income, gain, deduction, or loss of the partnership or S corporation are taken into account in applying the limitation under the proposal for the taxable year of the partner or S corporation. Regulatory authority is provided to apply the proposal to any other passthrough entity to the extent necessary

[36] Regulations provide more detailed standards for material participation. See Treas. Reg. sec. 1.469-5 and -5T.

[37] Sec. 461(j).

to carry out the proposal. Regulatory authority is also provided to require any additional reporting as the Secretary determines is appropriate to carry out the purposes of the proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

C. Reform of the Child Tax Credit

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against both the regular tax and the alternative minimum tax ("AMT"). To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit[38] (the "additional child tax credit") equal to 15 percent of earned income in excess of $3,000 (the "earned income" formula).

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. At the taxpayer's election, combat pay may be treated as earned income for these purposes. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possession) is not taken into account as income and is not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

[38] The refundable credit may not exceed the maximum credit per child of $1,000.

Description of Proposal

The proposal increases the child tax credit to $1,650 per qualifying child. Additionally, the age limit for a qualifying child is increased by one year, such that a taxpayer may claim the credit with respect to any qualifying child under the age of 18.

The credit is further modified to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The proposal generally retains the present-law definition of dependent.

In 2018, the threshold at which the credit begins to phase out is increased to $1,000,000 for married taxpayers filing a joint return and $500,000 in the case of all other taxpayers. These amounts are not indexed for inflation.

The proposal lower the earned income threshold for the refundable child tax credit to $2,500. As under present law, the maximum amount refundable may not exceed $1,000 per qualifying child. Under the proposal, this $1,000 threshold is indexed for inflation with a base year of 2017, rounding up to the nearest $100 (such that the threshold is $1,100 in 2018). In order to receive the refundable portion of the child tax credit, a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

D. Simplification and Reform of Deductions and Exclusions

1. Repeal of deduction for taxes not paid or accrued in a trade or business

Present Law

Individuals are permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes are: (i) State, local and foreign real property taxes;[39] (ii) State and local personal property taxes;[40] (iii) State, local and foreign income, war profits, and excess profits taxes.[41] At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes.[42]

Property taxes may be allowed as a deduction in computing adjusted gross income if incurred in connection with property used in a trade or business; otherwise they are an itemized deduction. In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.[43]

Individuals also are permitted a deduction for Federal and State generation skipping transfer tax ("GST tax") imposed on certain income distributions that are included in the gross income of the distributee.[44]

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.

Description of Proposal

The proposal provides that in the case of an individual, State, local and foreign property taxes and State and local sales taxes are allowed as a deduction only when paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).[45] Thus, the proposal allows only those deductions for State, local and foreign property taxes, and sales taxes, that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F on such individual's tax return. For

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[39] Sec. 164(a)(1).

[40] Sec. 164(a)(2).

[41] Sec. 164(a)(3). A foreign tax credit, in lieu of a deduction, is allowable for foreign taxes if the taxpayer so elects.

[42] Sec. 164(b)(5).

[43] See H. Rep. No. 1365 to accompany Individual Income Tax Bill of 1944 (78th Cong., 2d. Sess.), reprinted at 19 C.B. 839 (1944).

[44] Sec. 164(a)(4).

[45] The proposal does not modify the deductibility of GST tax imposed on certain income distributions.

instance, in the case of property taxes, an individual may deduct such items only if these taxes were imposed on business assets (such as residential rental property).

The proposal also provides that in the case of an individual, State and local income, war profits, and excess profits taxes are not allowable as a deduction.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Modification of deduction for home mortgage interest

Present Law

As a general matter, personal interest is not deductible.[46] Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations.[47] Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing or substantially improving a qualified residence of the taxpayer and which secures the residence. The maximum amount treated as acquisition indebtedness is $1 million ($500,000 in the case of a married person filing a separate return).

Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness. Thus, for example, if the taxpayer incurs $200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to $150,000, the taxpayer's acquisition indebtedness with respect to the residence cannot thereafter be increased above $150,000 (except by indebtedness incurred to substantially improve the residence).

Interest on acquisition indebtedness is allowable in computing alternative minimum taxable income. However, in the case of a second residence, the acquisition indebtedness may only be incurred with respect to a house, apartment, condominium, or a mobile home that is not used on a transient basis.

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[46] Sec. 163(h)(1).

[47] Sec. 163(h)(2)(D) and (h)(3).

Home equity indebtedness

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence.

The amount of home equity indebtedness may not exceed $100,000 ($50,000 in the case of a married individual filing a separate return) and may not exceed the fair market value of the residence reduced by the acquisition indebtedness.

Interest on home equity indebtedness is not deductible in computing alternative minimum taxable income.

Interest on qualifying home equity indebtedness is deductible, regardless of how the proceeds of the indebtedness are used. For example, personal expenditures may include health costs and education expenses for the taxpayer's family members or any other personal expenses such as vacations, furniture, or automobiles. A taxpayer and a mortgage company can contract for the home equity indebtedness loan proceeds to be transferred to the taxpayer in a lump sum payment (e.g., a traditional mortgage), a series of payments (*e.g.*, a reverse mortgage), or the lender may extend the borrower a line of credit up to a fixed limit over the term of the loan (*e.g.*, a home equity line of credit).

Thus, the aggregate limitation on the total amount of a taxpayer's acquisition indebtedness and home equity indebtedness with respect to a taxpayer's principal residence and a second residence that may give rise to deductible interest is $1,100,000 ($550,000, for married persons filing a separate return).

Description of Proposal

The proposal repeals the deduction for interest on home equity indebtedness.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Modification of deduction for personal casualty and theft losses

Present Law

A taxpayer may generally claim a deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft.[48] Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate

[48] Sec. 165(c).

net casualty and theft losses are deductible only to the extent they exceed ten percent of an individual taxpayer's adjusted gross income.

Description of Proposal

The proposal modifies the deduction for personal casualty and theft losses. Under the proposal, a taxpayer may claim a personal casualty loss (subject to the limitations described above) if such loss was incurred in a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Effective Date

The proposal is effective for losses incurred in taxable years beginning after December 31, 2017.

4. Repeal of deduction for tax preparation expenses

Present Law

For regular income tax purposes, individuals are allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.[49]

Description of Proposal

The proposal repeals the deduction for expenses in connection with the determination, collection, or refund of any tax.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

5. Repeal of miscellaneous itemized deductions subject to the two-percent floor

Present Law

Individuals may claim itemized deductions for certain miscellaneous expenses. Certain of these expenses are not deductible unless, in aggregate, they exceed two percent of the taxpayer's

[49] Sec. 212.

adjusted gross income ("AGI").[50] The deductions described below are subject to the aggregate two-percent floor.[51]

Expenses for the production or collection of income

Individuals may deduct all ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.[52]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[53]

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions from pass-through entities;
- Investment fees and expenses;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
- Repayments of income;
- Safe deposit box rental fees, except for storing jewelry and other personal effects;
- Service charges on dividend reinvestment plans; and
- Trustee's fees for an IRA, if separately billed and paid.

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[50] Sec. 67(a).

[51] The miscellaneous itemized deduction for tax preparation expenses is described in a separate section of this document.

[52] Sec. 212(1).

[53] See IRS Publication 529, "*Miscellaneous Deductions*" (2016), p. 9.

Unreimbursed expenses attributable to the trade or business of being an employee

In general, unreimbursed business expenses incurred by an employee are deductible, but only as an itemized deduction and only to the extent the expenses exceed two percent of adjusted gross income.[54]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[55]

- Business bad debt of an employee;
- Business liability insurance premiums;
- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer perform his job;
- Dues to professional societies;
- Educator expenses;[56]
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport fees for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's work;

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[54] Secs. 62(a)(1) and 67.

[55] See IRS Publication 529, "*Miscellaneous Deductions*" (2016), p. 3.

[56] Under a special provision, these expenses are deductible "above the line" up to $250.

- Tools and supplies used in the taxpayer's work;
- Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

<u>Other miscellaneous itemized deductions subject to the two-percent floor</u>

Other miscellaneous itemized deductions subject to the two-percent floor include:

- Repayments of income received under a claim of right (only subject to the two-percent floor if less than $3,000);
- Repayments of Social Security benefits; and
- The share of deductible investment expenses from pass-through entities.

<u>Description of Proposal</u>

The proposal repeals all miscellaneous itemized deductions that are subject to the two-percent floor under present law.[57]

<u>Effective Date</u>

The proposal is effective for taxable years beginning after December 31, 2017.

6. Increase percentage limit for charitable contributions of cash to public charities

<u>Present Law</u>

<u>In general</u>

The Code allows taxpayers to reduce their income tax liability by taking deductions for contributions to certain organizations, including charities, Federal, State, local and Indian tribal governments, and certain other organizations.

To be deductible, a charitable contribution generally must meet several threshold requirements. First, the recipient of the transfer must be eligible to receive charitable contributions (*i.e.*, an organization or entity described in section 170(c)). Second, the transfer must be made with gratuitous intent and without the expectation of a benefit of substantial

[57] For a description of the repeal of the deduction for tax preparation expenses, please see "Repeal of deduction for tax preparation expenses."

economic value in return. Third, the transfer must be complete and generally must be a transfer of a donor's entire interest in the contributed property (*i.e.*, not a contingent or partial interest contribution). To qualify for a current year charitable deduction, payment of the contribution must be made within the taxable year.[58] Fourth, the transfer must be of money or property—contributions of services are not deductible. Finally, the transfer must be substantiated and in the proper form.

As discussed below, special rules limit the deductibility of a taxpayer's charitable contributions in a given year to a percentage of income, and those rules, in part, turn on whether the organization receiving the contributions is a public charity or a private foundation. Other special rules determine the deductible value of contributed property for each type of property.

Percentage limits on charitable contributions

Individual taxpayers

Charitable contributions by individual taxpayers are limited to a specified percentage of the individual's contribution base. The contribution base is the taxpayer's adjusted gross income ("AGI") for a taxable year, disregarding any net operating loss carryback to the year under section 172.[59] In general, more favorable (higher) percentage limits apply to contributions of cash and ordinary income property than to contributions of capital gain property. More favorable limits also generally apply to contributions to public charities (and certain operating foundations) than to contributions to nonoperating private foundations.

More specifically, the deduction for charitable contributions by an individual taxpayer of cash and property that is not appreciated to a charitable organization described in section 170(b)(1)(A) (public charities, private foundations other than nonoperating private foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations generally may be deducted up to the lesser of 30 percent of the taxpayer's contribution base or the excess of (i) 50 percent of the contribution base over (ii) the amount of contributions subject to the 50 percent limitation.

Contributions of appreciated capital gain property to public charities and other organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base (after taking into account contributions other than contributions of capital gain property). An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to nonoperating private foundations are deductible up to the lesser of 20 percent of the taxpayer's contribution base or

[58] Sec. 170(a)(1).

[59] Sec. 170(b)(1)(G).

the excess of (i) 30 percent of the contribution base over (ii) the amount of contributions subject to the 30 percent limitation.

Finally, contributions that are for the use of (not to) the donee charity get less favorable percentage limits. Contributions of capital gain property for the use of public charities and other organizations described in section 170(b)(1)(A) also are limited to 20 percent of the taxpayer's contribution base. Property contributed for the use of an organization generally has been interpreted to mean property contributed in trust for the organization.[60] Charitable contributions of income interests (where deductible) also generally are treated as contributions for the use of the donee organization.

Table 3.–Charitable Contribution Percentage Limits For Individual Taxpayers[61]

	Ordinary Income Property and Cash	Capital Gain Property to the Recipient[62]	Capital Gain Property for the use of the Recipient
Public Charities, Private Operating Foundations, and Private Distributing Foundations	50%	30%[63]	20%
Nonoperating Private Foundations	30%	20%	20%

Corporate taxpayers

A corporation generally may deduct charitable contributions up to 10 percent of the corporation's taxable income for the year.[64] For this purpose, taxable income is determined without regard to: (1) the charitable contributions deduction; (2) any net operating loss carryback to the taxable year; (3) deductions for dividends received; (4) deductions for dividends

[60] *Rockefeller v. Commissioner*, 676 F.2d 35, 39 (2d Cir. 1982).

[61] Percentages shown are the percentage of an individual's contribution base.

[62] Capital gain property contributed to public charities, private operating foundations, or private distributing foundations will be subject to the 50-percent limitation if the donor elects to reduce the fair market value of the property by the amount that would have been long-term capital gain if the property had been sold.

[63] Certain qualified conservation contributions to public charities (generally, conservation easements), qualify for more generous contribution limits. In general, the 30-percent limit applicable to contributions of capital gain property is increased to 100 percent if the individual making the qualified conservation contribution is a qualified farmer or rancher or to 50 percent if the individual is not a qualified farmer or rancher.

[64] Sec. 170(b)(2)(A).

paid on certain preferred stock of public utilities; and (5) any capital loss carryback to the taxable year.[65]

Carryforwards of excess contributions

Charitable contributions that exceed the applicable percentage limit generally may be carried forward for up to five years.[66] In general, contributions carried over from a prior year are taken into account after contributions for the current year that are subject to the same percentage limit. Excess contributions made for the use of (rather than to) an organization generally may not be carried forward.

Qualified conservation contributions

Preferential percentage limits and carryforward rules apply for qualified conservation contributions.[67] In general, the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions. Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) (generally, public charities) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry forward any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years. In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[68]

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

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[65] Sec. 170(b)(2)(C).

[66] Sec. 170(d).

[67] Sec. 170(b)(1)(E).

[68] Sec. 170(b)(2)(B).

Description of Proposal

The proposal increases the income-based percentage limit described in section 170(b)(1)(A) for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent.

Effective Date

The proposal is effective for contributions made in taxable years beginning after December 31, 2017.

7. Repeal of overall limitation on itemized deductions

Present Law

The total amount of most otherwise allowable itemized deductions (other than the deductions for medical expenses, investment interest and casualty, theft or gambling losses) is limited for certain upper-income taxpayers.[69] All other limitations applicable to such deductions (such as the separate floors) are first applied and, then, the otherwise allowable total amount of itemized deductions is reduced by three percent of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount.

For 2017, the threshold amounts are $261,500 for single taxpayers, $287,650 for heads of household, $313,800 for married couples filing jointly, and $156,900 for married taxpayers filing separately. These threshold amounts are indexed for inflation. The otherwise allowable itemized deductions may not be reduced by more than 80 percent by reason of the overall limit on itemized deductions.

Description of Proposal

The proposal repeals the overall limitation on itemized deductions.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

8. Modification of exclusion of gain from sale of a principal residence

Present Law

A taxpayer who is an individual may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to the

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[69] Sec. 68.

fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period.

Description of Proposal

The proposal extends the length of time a taxpayer must own and use a residence to qualify for this exclusion. Specifically, under this proposal, the exclusion is available only if the taxpayer has owned and used the residence as a principal residence for at least five of the eight years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the five years that the ownership and use requirements are met.

Under the proposal, a taxpayer may benefit from the exclusion only once every five years.

Effective Date

The proposal is effective for sales and exchanges after December 31, 2017.

9. Repeal of exclusion for qualified bicycle commuting reimbursement

Present Law

Qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month are excludible from an employee's gross income.[70] A qualifying bicycle commuting month is any month during which the employee regularly uses the bicycle for a substantial portion of travel to a place of employment and during which the employee does not receive transportation in a commuter highway vehicle, a transit pass, or qualified parking from an employer.

Qualified reimbursements are any amount received from an employer during a 15-month period beginning with the first day of the calendar year as payment for reasonable expenses during a calendar year. Reasonable expenses are those incurred in a calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if the bicycle is regularly used for travel between the employee's residence and place of employment.

Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

[70] Section 132(a)(5) and 132(f)(1)(D).

Description of Proposal

The proposal repeals the exclusion from gross income and wages for qualified bicycle commuting reimbursements.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

10. Repeal of exclusion for qualified moving expense reimbursement

Present Law

Qualified moving expense reimbursements are excludible from an employee's gross income[71], and are defined as any amount received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses under section 217[72] if directly paid or incurred by the employee. However, qualified moving expense reimbursements do not include amounts actually deducted by the individual.

Amounts excludible from gross income for income tax purposes as qualified moving expense reimbursements are also excluded from wages for employment tax purposes.

Description of Proposal

The proposal repeals the exclusion from gross income and wages for qualified moving expense reimbursements.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

11. Repeal of deduction for moving expenses

Present Law

Individuals are permitted an above-the-line deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.[73] Such

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[71] Section 132(a)(6) and 132(g).

[72] Sec. 217(a). Individuals are allowed an itemized deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work. Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

[73] Sec. 217(a).

expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

Special rules apply in the case of a member of the Armed Forces of the United States. In the case of any such individual who is on active duty, who moves pursuant to a military order and incident to a permanent change of station, the limitations related to distance from the taxpayer's previous residence and status as a full-time employee in the new location do not apply.[74] Additionally, any moving and storage expenses which are furnished in kind to such an individual, spouse, or dependents, or if such expenses are reimbursed or an allowance for such expenses is provided, such amounts are excluded from gross income.[75] Rules also apply to exclude amounts furnished to the spouse and dependents of such an individual in the event that such individuals move to a location other than to where the member of the Armed Forces is moving.

Description of Proposal

The proposal generally repeals the deduction for moving expenses. However, under the proposal, rules providing for exclusions of amounts attributable to in-kind moving and storage expenses (and reimbursements or allowances for these expenses) for members of the Armed Forces of the United States (or their spouse or dependents) are not repealed.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

12. Modification to the limitation on wagering losses

Present Law

Losses sustained during the taxable year on wagering transactions are allowed as a deduction only to the extent of the gains during the taxable year from such transactions.[76]

Description of Proposal

The proposal clarifies the scope of "losses from wagering transactions" as that term is used in section 165(d). The proposal provides that this term includes any deduction otherwise allowable under chapter 1 of the Code incurred in carrying on any wagering transaction.

The proposal is intended to clarify that the limitation on losses from wagering transactions applies not only to the actual costs of wagers incurred by an individual, but to other

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[74] Sec. 217(g).

[75] Sec. 217(g)(2).

[76] Sec. 165(d).

expenses incurred by the individual in connection with the conduct of that individual's gambling activity.[77] The proposal clarifies, for instance, an individual's otherwise deductible expenses in traveling to or from a casino are subject to the limitation under section 165(d).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

[77] The proposal thus reverses the result reached by the Tax Court in *Ronald A. Mayo v. Commissioner*, 136 T.C. 81 (2011). In that case, the Court held that a taxpayer's expenses incurred in the conduct of the trade or business of gambling, other than the cost of wagers, were not limited by sec. 165(d), and were thus deductible under sec. 162(a).

E. Increase in Estate and Gift Tax Exemption

Present Law

In general

A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death. A generation-skipping transfer tax generally is imposed on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Income tax rules determine the recipient's tax basis in property acquired from a decedent or by gift. Gifts and bequests generally are excluded from the recipient's gross income.[78]

Common features of the estate, gift and generation-skipping transfer taxes

Unified credit (exemption) and tax rates

Unified credit.−A unified credit is available with respect to taxable transfers by gift and at death.[79] The unified credit offsets tax, computed using the applicable estate and gift tax rates, on a specified amount of transfers, referred to as the applicable exclusion amount, or exemption amount. The exemption amount was set at $5 million for 2011 and is indexed for inflation for later years.[80] For 2017, the inflation-indexed exemption amount is $5.49 million.[81] Exemption used during life to offset taxable gifts reduces the amount of exemption that remains at death to offset the value of a decedent's estate. An election is available under which exemption that is not used by a decedent may be used by the decedent's surviving spouse (exemption portability).

Common tax rate table.−A common tax-rate table with a top marginal tax rate of 40 percent is used to compute gift tax and estate tax. The 40-percent rate applies to transfers in excess of $1 million (to the extent not exempt). Because the exemption amount currently shields the first $5.49 million in gifts and bequests from tax, transfers in excess of the exemption amount generally are subject to tax at the highest marginal rate (40 percent).

Generation-skipping transfer tax exemption and rate.−The generation-skipping transfer tax is a separate tax that can apply in addition to either the gift tax or the estate tax. The tax rate

[78] Sec. 102.

[79] Sec. 2010.

[80] For 2011 and later years, the gift and estate taxes were reunified, meaning that the gift tax exemption amount was increased to equal the estate tax exemption amount.

[81] For 2017, the $5.49 exemption amount results in a unified credit of $2,141,800, after applying the applicable rates set forth in section 2001(c).

and exemption amount for generation-skipping transfer tax purposes, however, are set by reference to the estate tax rules. Generation-skipping transfer tax is imposed using a flat rate equal to the highest estate tax rate (40 percent). Tax is imposed on cumulative generation-skipping transfers in excess of the generation-skipping transfer tax exemption amount in effect for the year of the transfer. The generation-skipping transfer tax exemption for a given year is equal to the estate tax exemption amount in effect for that year (currently $5.49 million).

Transfers between spouses.–A 100-percent marital deduction generally is permitted for the value of property transferred between spouses.[82] In addition, transfers of "qualified terminable interest property" also are eligible for the marital deduction. Qualified terminable interest property is property: (1) that passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) to which an election under these rules applies. A qualifying income interest for life exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or has the right to use the property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

A marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States. A marital deduction is permitted, however, for property passing to a qualified domestic trust of which the noncitizen surviving spouse is a beneficiary. A qualified domestic trust is a trust that has as its trustee at least one U.S. citizen or U.S. corporation. No corpus may be distributed from a qualified domestic trust unless the U.S. trustee has the right to withhold any estate tax imposed on the distribution.

Tax is imposed on (1) any distribution from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse. The tax is computed as an additional estate tax on the estate of the first spouse to die.

Transfers to charity.–Contributions to section 501(c)(3) charitable organizations and certain other organizations may be deducted from the value of a gift or from the value of the assets in an estate for Federal gift or estate tax purposes.[83] The effect of the deduction generally is to remove the full fair market value of assets transferred to charity from the gift or estate tax base; unlike the income tax charitable deduction, there are no percentage limits on the deductible amount. For estate tax purposes, the charitable deduction is limited to the value of the transferred property that is required to be included in the gross estate.[84] A charitable contribution

[82] Secs. 2056 and 2523.

[83] Secs. 2055 and 2522.

[84] Sec. 2055(d).

of a partial interest in property, such as a remainder or future interest, generally is not deductible for gift or estate tax purposes.[85]

Estate tax

Overview

The Code imposes a tax on the transfer of the taxable estate of a decedent who is a citizen or resident of the United States.[86] The taxable estate is determined by deducting from the value of the decedent's gross estate any deductions provided for in the Code. After applying tax rates to determine a tentative amount of estate tax, certain credits are subtracted to determine estate tax liability.[87]

Because the estate tax shares a common unified credit (exemption) and tax rate table with the gift tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

Gross estate

A decedent's gross estate includes, to the extent provided for in other sections of the Code, the date-of-death value of all of a decedent's property, real or personal, tangible or intangible, wherever situated.[88] In general, the value of property for this purpose is the fair market value of the property as of the date of the decedent's death, although an executor may elect to value certain property as of the date that is six months after the decedent's death (the alternate valuation date).[89]

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[85] Secs. 2055(e)(2) and 2522(c)(2).

[86] Sec. 2001(a).

[87] More mechanically, the taxable estate is combined with the value of adjusted taxable gifts made during the decedent's life (generally, post-1976 gifts), before applying tax rates to determine a tentative total amount of tax. The portion of the tentative tax attributable to lifetime gifts is then subtracted from the total tentative tax to determine the gross estate tax, *i.e.*, the amount of estate tax before considering available credits. Credits are then subtracted to determine the estate tax liability.

This method of computation was designed to ensure that a taxpayer only gets one run up through the rate brackets for all lifetime gifts and transfers at death, at a time when the thresholds for applying the higher marginal rates exceeded the exemption amount. However, the higher ($5.49 million) present-law exemption amount effectively renders the lower rate brackets irrelevant, because the top marginal rate bracket applies to all transfers in excess of $1 million. In other words, all transfers that are not exempt by reason of the $5.49 million exemption amount are taxed at the highest marginal rate of 40 percent.

[88] Sec. 2031(a).

[89] Sec. 2032.

The gross estate includes not only property directly owned by the decedent, but also other property in which the decedent had a beneficial interest at the time of his or her death.[90] The gross estate also includes certain transfers made by the decedent prior to his or her death, including: (1) certain gifts made within three years prior to the decedent's death;[91] (2) certain transfers of property in which the decedent retained a life estate;[92] (3) certain transfers taking effect at death;[93] and (4) revocable transfers.[94] In addition, the gross estate also includes property with respect to which the decedent had, at the time of death, a general power of appointment (generally, the right to determine who will have beneficial ownership).[95] The value of a life insurance policy on the decedent's life is included in the gross estate if the proceeds are payable to the decedent's estate or the decedent had incidents of ownership with respect to the policy at the time of his or her death.[96]

Deductions from the gross estate

A decedent's taxable estate is determined by subtracting from the value of the gross estate any deductions provided for in the Code.

Marital and charitable transfers.−As described above, transfers to a surviving spouse or to charity generally are deductible for estate tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the estate tax base.

State death taxes.−An estate tax deduction is permitted for death taxes (*e.g.*, any estate, inheritance, legacy, or succession taxes) actually paid to any State or the District of Columbia, in respect of property included in the gross estate of the decedent.[97] Such State taxes must have been paid and claimed before the later of: (1) four years after the filing of the estate tax return; or (2) (a) 60 days after a decision of the U.S. Tax Court determining the estate tax liability becomes final, (b) the expiration of the period of extension to pay estate taxes over time under section 6166, or (c) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has become final.

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[90] Sec. 2033.

[91] Sec. 2035.

[92] Sec. 2036.

[93] Sec. 2037.

[94] Sec. 2038.

[95] Sec. 2041.

[96] Sec. 2042.

[97] Sec. 2058.

Other deductions.−A deduction is available for funeral expenses, estate administration expenses, and claims against the estate, including certain taxes.[98] A deduction also is available for uninsured casualty and theft losses incurred during the settlement of the estate.[99]

Credits against tax

After accounting for allowable deductions, a gross amount of estate tax is computed. Estate tax liability is then determined by subtracting allowable credits from the gross estate tax.

Unified credit.−The most significant credit allowed for estate tax purposes is the unified credit, which is discussed in greater detail above.[100] For 2017, the value of the unified credit is $2,141,800, which has the effect of exempting $5.49 million in transfers from tax. The unified credit available at death is reduced by the amount of unified credit used to offset gift tax on gifts made during the decedent's life.

Other credits.−Estate tax credits also are allowed for: (1) gift tax paid on certain pre-1977 gifts (before the estate and gift tax computations were integrated);[101] (2) estate tax paid on certain prior transfers (to limit the estate tax burden when estate tax is imposed on transfers of the same property in two estates by reason of deaths in rapid succession);[102] and (3) certain foreign death taxes paid (generally, where the property is situated in a foreign country but included in the decedent's U.S. gross estate).[103]

Provisions affecting small and family-owned businesses and farms

Special-use valuation.−An executor can elect to value for estate tax purposes certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current-use value, rather than its fair market value.[104] The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997; the inflation-adjusted amount for 2017 is $1,120,000). In general, real property qualifies for special-use valuation only if (1) at least 50 percent of the adjusted value of the decedent's gross estate (including both real and personal property) consists of a farm or closely-held business property in the decedent's estate and (2) at least 25 percent of the adjusted value of the gross estate consists of farm or

[98] Sec. 2053.

[99] Sec. 2054.

[100] Sec. 2010.

[101] Sec. 2012.

[102] Sec. 2013.

[103] Sec. 2014. In certain cases, an election may be made to deduct foreign death taxes. See section 2053(d).

[104] Sec. 2032A.

closely held business real property. In addition, the property must be used in a qualified use (*e.g.*, farming) by the decedent or a member of the decedent's family for five of the eight years before the decedent's death.

If, after a special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death, an additional estate tax is imposed to recapture the entire estate-tax benefit of the special-use valuation.

Installment payment of estate tax for closely held businesses.–Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely held business in two or more installments (but no more than 10).[105] An estate is eligible for payment of estate tax in installments if the value of the decedent's interest in a closely held business exceeds 35 percent of the decedent's adjusted gross estate (*i.e.*, the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax. A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998; the inflation-adjusted amount for 2017 is $1,490,000) in taxable value of a closely held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely held business in excess of $1 million (adjusted for inflation) is equal to 45 percent of the rate applicable to underpayments of tax under section 6621 of the Code (*i.e.*, 45 percent of the Federal short-term rate plus three percentage points).[106] Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

The gift tax

Overview

The Code imposes a tax for each calendar year on the transfer of property by gift during such year by any individual, whether a resident or nonresident of the United States.[107] The amount of taxable gifts for a calendar year is determined by subtracting from the total amount of gifts made during the year: (1) the gift tax annual exclusion (described below); and (2) allowable deductions.

Gift tax for the current taxable year is determined by: (1) computing a tentative tax on the combined amount of all taxable gifts for the current and all prior calendar years using the common gift tax and estate tax rate table; (2) computing a tentative tax only on all prior-year gifts; (3) subtracting the tentative tax on prior-year gifts from the tentative tax computed for all

[105] Sec. 6166.

[106] The interest rate on this portion adjusts with the Federal short-term rate.

[107] Sec. 2501(a).

years to arrive at the portion of the total tentative tax attributable to current-year gifts; and, finally, (4) subtracting the amount of unified credit not consumed by prior-year gifts.

Because the gift tax shares a common unified credit (exemption) and tax rate table with the estate tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

Transfers by gift

The gift tax applies to a transfer by gift regardless of whether: (1) the transfer is made outright or in trust; (2) the gift is direct or indirect; or (3) the property is real or personal, tangible or intangible.[108] For gift tax purposes, the value of a gift of property is the fair market value of the property at the time of the gift.[109] Where property is transferred for less than full consideration, the amount by which the value of the property exceeds the value of the consideration is considered a gift and is included in computing the total amount of a taxpayer's gifts for a calendar year.[110]

For a gift to occur, a donor generally must relinquish dominion and control over donated property. For example, if a taxpayer transfers assets to a trust established for the benefit of his or her children, but retains the right to revoke the trust, the taxpayer may not have made a completed gift, because the taxpayer has retained dominion and control over the transferred assets. A completed gift made in trust, on the other hand, often is treated as a gift to the trust beneficiaries.

By reason of statute, certain transfers are not treated as transfers by gift for gift tax purposes. These include, for example, certain transfers for educational and medical purposes,[111] transfers to section 527 political organizations,[112] and transfers to tax-exempt organizations described in sections 501(c)(4), (5), or (6).[113]

Taxable gifts

As stated above, the amount of a taxpayer's taxable gifts for the year is determined by subtracting from the total amount of the taxpayer's gifts for the year the gift tax annual exclusion and any available deductions.

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[108] Sec. 2511(a).

[109] Sec. 2512(a).

[110] Sec. 2512(b).

[111] Sec. 2503(e).

[112] Sec. 2501(a)(4).

[113] Sec. 2501(a)(6).

Gift tax annual exclusion.–Under present law, donors of lifetime gifts are provided an annual exclusion of $14,000 per donee in 2017 (indexed for inflation from the 1997 annual exclusion amount of $10,000) for gifts of present interests in property during the taxable year.[114] If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $28,000 per donee in 2017. In general, unlimited transfers between spouses are permitted without imposition of a gift tax. Special rules apply to the contributions to a qualified tuition program ("529 Plan") including an election to treat a contribution that exceeds the annual exclusion as a contribution made ratably over a five-year period beginning with the year of the contribution.[115]

Marital and charitable deductions.–As described above, transfers to a surviving spouse or to charity generally are deductible for gift tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the gift tax base.

The generation-skipping transfer tax

A generation-skipping transfer tax generally is imposed (in addition to the gift tax or the estate tax) on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Exemption and tax rate

An exemption generally equal to the estate tax exemption amount ($5.49 million for 2017) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property, and in some cases is automatically allocated. The allocation of generation-skipping transfer tax exemption effectively reduces the tax rate on a generation-skipping transfer.

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate (40 percent) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred indicates the amount of "generation-skipping transfer tax exemption" allocated to a trust (or to property transferred in a direct skip) relative to the total value of property transferred.[116] If, for example, a taxpayer transfers $5 million in property to a trust and allocates $5 million of exemption to the transfer, the inclusion ratio is zero, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is zero percent (40 percent multiplied by the inclusion ratio of zero). If, however, the taxpayer allocated only $2.5 million of exemption to the transfer, the inclusion ratio is 0.5, and the applicable tax rate on

[114] Sec. 2503(b).

[115] Sec. 529(c)(2).

[116] The inclusion ratio is one minus the applicable fraction. The applicable fraction is the amount of exemption allocated to a trust (or to a direct skip) divided by the value of assets transferred.

any subsequent generation-skipping transfers from the trust is 20 percent (40 percent multiplied by the inclusion ratio of 0.5). If the taxpayer allocates no exemption to the transfer, the inclusion ratio is one, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is 40 percent (40 percent multiplied by the inclusion ratio of one).

Generation-skipping transfers

Generation-skipping transfer tax generally is imposed at the time of a generation-skipping transfer − a direct skip, a taxable termination, or a taxable distribution.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (*e.g.*, grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person.

A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates generation-skipping transfer tax exemption to a trust prior to the taxable distribution, generation-skipping transfer tax may be avoided.

Income tax basis in property received

In general

Gain or loss, if any, on the disposition of property is measured by the taxpayer's amount realized (*i.e.*, gross proceeds received) on the disposition, less the taxpayer's basis in such property. Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

A gift or bequest of appreciated (or loss) property is not an income tax realization event for the transferor. The Code provides special rules for determining a recipient's basis in assets received by lifetime gift or from a decedent.

Basis in property received by lifetime gift

Under present law, property received from a donor of a lifetime gift generally takes a carryover basis. "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the

gift. If a donor's basis in property is greater than the fair market value of the property on the date of the gift, then, for purposes of determining loss on a subsequent sale of the property, the donee's basis is the property's fair market value on the date of the gift.

Basis in property acquired from a decedent

Property acquired from a decedent's estate generally takes a stepped-up basis. "Stepped-up basis" means that the basis of property acquired from a decedent's estate generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). Providing a fair market value basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent's death and eliminates the tax benefit from any unrealized loss.

In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent and, thus, is eligible for stepped-up basis. Thus, both the decedent's one-half share and the surviving spouse's one-half share are stepped up to fair market value. This rule applies if at least one-half of the whole of the community interest is includible in the decedent's gross estate.

Stepped-up basis treatment generally is denied to certain interests in foreign entities. Stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that stock of a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped-up basis. Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped-up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (*i.e.*, generally the date of the decedent's death unless an alternate valuation date is elected).

Description of Proposal

The proposal doubles the estate and gift tax exemption amount. This is accomplished by increasing the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011.

Effective Date

The proposal is effective for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017.

II. ALTERNATIVE MINIMUM TAX REPEAL

1. Repeal of alternative minimum tax

Present Law

Individual alternative minimum tax

In general

An alternative minimum tax ("AMT") is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. For taxable years beginning in 2017, the tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $187,800 ($93,900 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The breakpoints are indexed for inflation. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the taxable income adjusted to take account of specified tax preferences and adjustments.

The exemption amounts for taxable years beginning in 2017 are: (1) $84,500 in the case of married individuals filing a joint return and surviving spouses; (2) $54,300 in the case of other unmarried individuals; (3) $42,250 in the case of married individuals filing separate returns; and (4) $24,100 in the case of an estate or trust. For taxable years beginning in 2017, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $160,900 in the case of married individuals filing a joint return and surviving spouses, (2) $120,700 in the case of other unmarried individuals, and (3) $80,450 in the case of married individuals filing separate returns or an estate or a trust. The amounts are indexed for inflation.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Preference items in computing AMTI

The minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of each mineral property (other than oil and gas properties) at the end of the taxable year.

2. The amount by which excess intangible drilling costs (*i.e.*, expenses in excess the amount that would have been allowable if amortized over a 10-year period) exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference applies to independent producers only to the extent it reduces the producer's AMTI (determined without regard to this preference and the net operating loss deduction) by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

5. Seven percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm activity or passive activities are not taken into account in computing AMTI.

Adjustments in computing AMTI

The adjustments that individuals must make to compute AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs are capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

4. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

5. Mining exploration and development costs are capitalized and amortized over a 10-year period.

6. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

7. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), is calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

8. Miscellaneous itemized deductions are not allowed.

9. Itemized deductions for State, local, and foreign real property taxes; State and local personal property taxes; State, local, and foreign income, war profits, and excess profits taxes; and State and local sales taxes are not allowed.

10. Medical expenses are allowed only to the extent they exceed ten percent of the taxpayer's adjusted gross income.

11. Deductions for interest on home equity loans are not allowed.

12. The standard deduction and the deduction for personal exemptions are not allowed.

13. The amount allowable as a deduction for circulation expenditures is capitalized and amortized over a three-year period.

14. The amount allowable as a deduction for research and experimentation expenditures from passive activities is capitalized and amortized over a 10-year period.

15. The regular tax rules relating to incentive stock options do not apply.

Other rules

The taxpayer's net operating loss deduction generally cannot reduce the taxpayer's AMTI by more than 90 percent of the AMTI (determined without the net operating loss deduction).

The alternative minimum tax foreign tax credit reduces the tentative minimum tax.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax liability in such subsequent year. The AMT credit is allowed only to the extent that the taxpayer's AMT liability is the result of adjustments that are timing in nature. The

individual AMT adjustments relating to itemized deductions and personal exemptions are not timing in nature, and no minimum tax credit is allowed with respect to these items.

An individual may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Corporate alternative minimum tax

In general

An AMT is also imposed on a corporation to the extent the corporation's tentative minimum tax exceeds its regular tax. This tentative minimum tax is computed at the rate of 20 percent on the AMTI in excess of a $40,000 exemption amount that phases out. The exemption amount is phased out by an amount equal to 25 percent of the amount that the corporation's AMTI exceeds $150,000.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation with average gross receipts of less than $7.5 million for the prior three taxable years is exempt from the corporate minimum tax. The $7.5 million threshold is reduced to $5 million for the corporation's first three-taxable year period.

Preference items in computing AMTI

The corporate minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

2. The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

Adjustments in computing AMTI

The adjustments that corporations must make in computing AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property which is allowed "bonus depreciation" for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs must be capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

4. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

5. The special rules applicable to Merchant Marine construction funds are not applicable.

6. The special deduction allowable under section 833(b) for Blue Cross and Blue Shield organizations is not allowed.

7. The adjusted current earnings adjustment applies, as described below.

Adjusted current earning ("ACE") adjustment

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings of a corporation exceed its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction). In determining ACE the following rules apply:

1. For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.

2. Amounts excluded from gross income under the regular tax but included for purposes of determining earnings and profits are generally included in determining ACE.

3. The inside build-up of a life insurance contract is included in ACE (and the related premiums are deductible).

4. Intangible drilling costs of integrated oil companies must be capitalized and amortized over a 60-month period.

5. The regular tax rules of section 173 (allowing circulation expenses to be amortized) and section 248 (allowing organizational expenses to be amortized) do not apply.

6. Inventory must be calculated using the FIFO, rather than LIFO, method.

7. The installment sales method generally may not be used.

8. No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

9. Depletion (other than for oil and gas properties) must be calculated using the cost, rather than the percentage, method.

10. In certain cases, the assets of a corporation that has undergone an ownership change must be stepped down to their fair market values.

<u>Other rules</u>

The taxpayer's net operating loss carryover generally cannot reduce the taxpayer's AMT liability by more than 90 percent of AMTI determined without this deduction.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If a corporation is subject to AMT in any year, the amount of AMT is allowed as an AMT credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in the subsequent year. Corporations are allowed to claim a limited amount of AMT credits in lieu of bonus depreciation.

A corporation may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Description of Proposal

The proposal repeals the individual and corporate alternative minimum tax.

The proposal allows the AMT credit to offset the taxpayer's regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit will be allowed in taxable years beginning before 2022.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

III. BUSINESS TAX REFORM

A. Tax Rates

1. Reduction in corporate tax rate

Present Law

Corporate taxable income is subject to tax under a four-step graduated rate structure.[117] The top corporate tax rate is 35 percent on taxable income in excess of $10 million. The corporate taxable income brackets and tax rates are as set forth in the table below.

Taxable Income	Tax rate (percent)
Not over $50,000	15
Over $50,000 but not over $75,000	25
Over $75,000 but not over $10,000,000	34
Over $10,000,000	35

An additional five-percent tax is imposed on a corporation's taxable income in excess of $100,000. The maximum additional tax is $11,750. Also, a second additional three-percent tax is imposed on a corporation's taxable income in excess of $15 million. The maximum second additional tax is $100,000.

Certain personal service corporations pay tax on their entire taxable income at the rate of 35 percent.[118]

Present law provides if the maximum corporate tax rate exceeds 35 percent, the maximum rate on a corporation's net capital gain will be 35 percent.[119]

Description of Proposal

The proposal eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 20 percent.

The proposal eliminates the special tax rate for personal service corporations.

[117] Sec. 11(a) and (b)(1).

[118] Sec. 11(b)(2).

[119] Sec. 1201(a).

The proposal repeals the maximum corporate tax rate on net capital gain as obsolete.

For taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the proposal provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the date of enactment).

Effective Date

The proposal applies to taxable years beginning after December 31, 2018.

2. Reduction of dividends received deductions to reflect lower corporate tax rate

Present Law

Corporations are generally taxable on their income.[120] With respect to dividends received from other taxable domestic corporations, however, a corporation is allowed a deduction.[121] The amount of the deduction is generally equal to 70 percent of the dividend received.

In the case of any dividend received from a 20-percent owned corporation, the amount of the deduction is equal to 80 percent of the dividend received.[122] The term "20-percent owned corporation" means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. For this purpose, certain preferred stock is not taken into account.

In the case of a dividend received from a corporation that is a member of the same affiliated group, a corporation is generally allowed a deduction equal to 100 percent of the dividend received.[123]

Description of Proposal

The proposal reduces the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.[124]

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[120] Sec. 11(a).

[121] Sec. 243(a). Such dividends are taxed at a maximum rate of 10.5 percent (30 percent of the top corporate tax rate of 35 percent).

[122] Sec. 243(c). Such dividends are taxed at a maximum rate of 7 percent (20 percent of the top corporate tax rate of 35 percent).

[123] Sec. 243(a)(3) and (b)(1). For this purpose, the term "affiliated group" generally has the meaning given such term by section 1504(a). Sec. 243(b)(2).

[124] Such dividends would be taxed at a maximum rate of 10 percent (50 percent of the top corporate tax rate of 20 percent) and 7 percent (35 percent of the top corporate tax rate of 20 percent), respectively.

Effective Date

The proposal applies to taxable years beginning after December 31, 2018.

B. Small Business Reforms

1. Modification of rules for expensing depreciable business assets

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[125] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[126] and convention.[127]

Election to expense certain depreciable business assets

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation. The maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year.[128] The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.[129] The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2015.[130]

In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Qualifying property also includes off-the-shelf computer software and qualified real property (*i.e.*, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement

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[125] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

[126] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[127] Sec. 168.

[128] Sec. 179(b)(1).

[129] Sec. 179(b)(2).

[130] Sec. 179(b)(6).

property).[131] Qualifying property excludes any property described in section 50(b) (*i.e.*, certain property not eligible for the investment tax credit).[132]

Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F. For sport utility vehicles above the 6,000 pound weight rating and not more than the 14,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000 (the "sport utility vehicle limitation").[133]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision).[134] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations).

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[135] If a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.[136]

An expensing election is made under rules prescribed by the Secretary.[137] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner.

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[131] Sec. 179(d)(1)(A)(ii) and (f).

[132] Sec. 179(d)(1) flush language. Property described in section 50(b) is generally property used outside the United States, certain property used for lodging, property used by certain tax exempt organizations, and property used by governmental units and foreign persons or entities.

[133] Sec. 179(b)(5). For this purpose, a sport utility vehicle is defined to exclude any vehicle that: (1) is designed for more than nine individuals in seating rearward of the driver's seat; (2) is equipped with an open cargo area, or a covered box not readily accessible from the passenger compartment, of at least six feet in interior length; or (3) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

[134] Sec. 179(b)(3).

[135] Sec. 179(d)(9).

[136] Sec. 312(k)(3)(B).

[137] Sec. 179(c)(1).

Description of Proposal

The proposal increases the maximum amount a taxpayer may expense under section 179 to $1,000,000, and increases the phase-out threshold amount to $2,500,000. Thus, the proposal provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017, is $1,000,000 of the cost of qualifying property placed in service for the taxable year. The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000. The $1,000,000 and $2,500,000 amounts, as well as the $25,000 sport utility vehicle limitation, are indexed for inflation for taxable years beginning after 2018.

The proposal expands the definition of section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.[138]

The proposal also expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Effective Date

The proposal applies to property placed in service in taxable years beginning after December 31, 2017.

2. Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships

Present Law

General rule for methods of accounting

Section 446 generally allows a taxpayer to select the method of accounting to be used to compute taxable income, provided that such method clearly reflects the income of the taxpayer. The term "method of accounting" includes not only the overall method of accounting used by the taxpayer, but also the accounting treatment of any one item.[139] Permissible overall methods of accounting include the cash receipts and disbursements method ("cash method"), an accrual method, or any other method (including a hybrid method) permitted under regulations prescribed

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[138] As defined in section 50(b)(2). Property used predominantly to furnish lodging or in connection with furnishing lodging generally includes, *e.g.*, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let. See Treas. Reg. sec. 1.48-1(h).

[139] Treas. Reg. sec. 1.446-1(a)(1).

by the Secretary.[140] Examples of any one item for which an accounting method may be adopted include cost recovery,[141] revenue recognition,[142] and timing of deductions.[143] For each separate trade or business, a taxpayer is entitled to adopt any permissible method, subject to certain restrictions.[144]

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[145] Except as otherwise provided, section 446(e) requires taxpayers to secure consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how an adoption of a method of accounting occurs, and (3) how a change in method of accounting is effectuated.[146]

Cash and accrual methods

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

Taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.[147] Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.[148] Accrual methods of accounting generally result in a more accurate measure of economic income than does the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method.

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[140] Sec. 446(c).

[141] See, *e.g.*, secs. 167 and 168.

[142] See, *e.g.*, secs. 451 and 460.

[143] See, *e.g.*, secs. 461 and 467.

[144] Sec. 446(d); Treas. Reg. sec. 1.446-1(d).

[145] Treas. Reg. sec. 1.446-1(e)(1).

[146] Treas. Reg. sec. 1.446-1(e).

[147] See, *e.g.*, sec. 451.

[148] See, *e.g.*, sec. 461.

Exceptions are made for farming businesses, qualified personal service corporations, and the aforementioned entities to the extent their average annual gross receipts do not exceed $5 million for all prior years (including the prior taxable years of any predecessor of the entity) (the "gross receipts test"). The cash method may not be used by any tax shelter.[149] In addition, the cash method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.[150] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[151]

A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees.[152] Such farming businesses are not precluded from using the cash method regardless of whether they meet the gross receipts test. However, section 447 generally requires a farming C corporation (and any farming partnership if a corporation is a partner in such partnership) to use an accrual method of accounting. Section 447 does not apply to nursery or sod farms, to the raising or harvesting of trees (other than fruit and nut trees), nor to farming C corporations meeting a gross receipts test with a $1 million threshold. For family farm C corporations, the threshold under the gross receipts test is $25 million.

A qualified personal service corporation is a corporation: (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or heirs. Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the gross receipts test.

Description of Proposal

The proposal expands the universe of taxpayers that may use the cash method of accounting. Under the proposal, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $15 million for the three prior taxable-year

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[149] Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale; (2) any syndicate (within the meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

[150] Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

[151] Sec. 471 and Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

[152] Sec. 448(d)(1).

period (the "$15 million gross receipts test") to use the cash method.[153] The $15 million amount is indexed for inflation for taxable years beginning after 2018.

The proposal retains the exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations. Thus, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other passthrough entities are allowed to use the cash method without regard to whether they meet the $15 million gross receipts test, so long as the use of such method clearly reflects income.[154]

The proposal expands the universe of farming C corporations (and farming partnerships with a C corporation partner) that may use the cash method to include any farming C corporation (or farming partnership with a C corporation partner) that meets the $15 million gross receipts test. The proposal retains the $25 million dollar limit for family farming corporations, but uses the $15 million gross receipts test in section 448 (substituting a $25 million threshold for the $15 million threshold). The $25 million amount is indexed for inflation for taxable years beginning after 2018.

If a taxpayer changes its method of accounting because it is either prohibited or no longer prohibited from using the cash method by reason of this proposal, such change is treated as initiated by the taxpayer and made with the consent of the Secretary.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017. Application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

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[153] Consistent with present law, the cash method generally may not be used by taxpayers if the purchase, production, or sale of merchandise is an income-producing factor. However, for taxable years beginning after December 31, 2017, under other provisions described in this document, an exception to the requirement to use inventories is provided for taxpayers that meet the $15 million gross receipts test, thus allowing such taxpayers to also use the cash method. See section III.B.3. of this document (Clarification of inventory accounting rules for small businesses). In addition, the cash method may not be used by a tax shelter.

[154] Consistent with present law, the cash method generally may not be used by taxpayers if the purchase, production, or sale of merchandise is an income-producing factor. However, for taxable years beginning after December 31, 2017, under other provisions of described in this document, an exception to the requirement to use inventories is provided for taxpayers that meet the $15 million gross receipts test, thus allowing such taxpayers to also use the cash method. See section III.B.3. of this document (Clarification of inventory accounting rules for small businesses). In addition, the cash method may not be used by a tax shelter.

3. Clarification of inventory accounting rules for small businesses

Present Law

In general, for Federal income tax purposes, taxpayers must account for inventories if the production, purchase, or sale of merchandise is an income-producing factor to the taxpayer.[155] Treasury regulations also provide that in any case in which the use of inventories is necessary to clearly reflect income, the accrual method must be used with regard to purchases and sales.[156] However, an exception is provided for taxpayers whose average annual gross receipts do not exceed $1 million.[157] A second exception is provided for taxpayers in certain industries whose average annual gross receipts do not exceed $10 million and that are not otherwise prohibited from using the cash method under section 448.[158] Such taxpayers may account for inventory as materials and supplies that are not incidental (*i.e.*, "non-incidental materials and supplies").[159]

In those circumstances in which a taxpayer is required to account for inventory, the taxpayer must maintain inventory records to determine the cost of goods sold during the taxable period. Cost of goods sold generally is determined by adding the taxpayer's inventory at the beginning of the period to the purchases made during the period and subtracting from that sum the taxpayer's inventory at the end of the period.

Because of the difficulty of accounting for inventory on an item-by-item basis, taxpayers often use conventions that assume certain item or cost flows. Among these conventions are the first-in, first-out ("FIFO") method, which assumes that the items in ending inventory are those most recently acquired by the taxpayer, and the last-in, first-out ("LIFO") method, which assumes that the items in ending inventory are those earliest acquired by the taxpayer.

Description of Proposal

The proposal exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $15 million gross receipts test[160] are not required to account for inventories under section 471[161], but rather may use a method of accounting for inventories

[155] Sec. 471(a) and Treas. Reg. sec. 1.471-1.

[156] Treas. Reg. sec. 1.446-1(c)(2).

[157] Rev. Proc. 2001-10, 2001-1 C.B. 272.

[158] Rev. Proc. 2002-28, 2002-1 C.B. 815.

[159] Treas. Reg. sec. 1.162-3(a)(1). A deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations.

[160] The $15 million gross receipts test is described in section III.B.2. of this document (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships).

[161] In the case of a sole proprietorship, the $15 million gross receipts test is applied as if the sole proprietorship were a corporation. The cash method generally may not be used by taxpayers if the purchase, production, or sale of merchandise is an income-producing factor. However, for taxpayers that meet the $15 million

that either (1) treats inventories as non-incidental materials and supplies[162], or (2) conforms to the taxpayer's financial accounting treatment of inventories.[163]

If a taxpayer changes its method of accounting because it is either no longer required or is required to use inventories by reason of this proposal, such change is treated as initiated by the taxpayer and made with the consent of the Secretary.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017. Application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

4. Modification of rules for uniform capitalization of certain expenses

Present Law

The uniform capitalization rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.[164] For real or personal property acquired by the taxpayer for resale, section 263A generally requires certain direct and indirect costs allocable to such property to be included in inventory.

Section 263A provides a number of exceptions to the general uniform capitalization requirements. One such exception exists for certain small taxpayers who acquire property for resale and have $10 million or less of average annual gross receipts;[165] such taxpayers are not required to include additional section 263A costs in inventory.

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gross receipts test to be exempt from accounting for inventories under section 471, such taxpayers are thus also eligible to use the cash method under the proposal. See section III.B.2. of this document (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships).

[162] Consistent with present law, a deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations. See Treas. Reg. sec. 1.162-3(a)(1).

[163] The taxpayer's financial accounting treatment of inventories is determined by reference to the method of accounting used in the taxpayer's applicable financial statement (as defined in section III.E.1. of this document (Certain special rules for taxable year of inclusion)) or, if the taxpayer does not have an applicable financial statement, the method of accounting used in the taxpayer's book and records prepared in accordance with the taxpayer's accounting procedures.

[164] Sec. 263A.

[165] Sec. 263A(b)(2)(B). No exception is available for small taxpayers who produce property subject to section 263A. However, a *de minimis* rule under Treasury regulations treats producers with total indirect costs of $200,000 or less as having no additional indirect costs beyond those normally capitalized for financial accounting purposes. Treas. Reg. sec. 1.263A-2(b)(3)(iv).

Another exception exists for taxpayers who raise, harvest, or grow trees.[166] Under this exception, section 263A does not apply to trees raised, harvested, or grown by the taxpayer (other than trees bearing fruit, nuts, or other crops, or ornamental trees) and any real property underlying such trees. Similarly, the uniform capitalization rules do not apply to any plant having a preproductive period of two years or less or to any animal, which is produced by a taxpayer in a farming business (unless the taxpayer is required to use an accrual method of accounting under section 447 or 448(a)(3)).[167]

Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[168]

Description of Proposal

The proposal expands the exception for small taxpayers from the uniform capitalization rules. Under the proposal, any producer or reseller that meets the $15 million gross receipts test[169] is exempted from the application of section 263A.[170] The proposal retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts.

If a taxpayer changes its method of accounting because it is either no longer required or is required to apply section 263A by reason of this proposal, such change is treated as initiated by the taxpayer and made with the consent of the Secretary.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017. Application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

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166 Sec. 263A(c)(5).

167 Sec. 263A(d).

168 Sec. 263A(h). Qualified creative expenses are defined as amounts paid or incurred by an individual in the trade or business of being a writer, photographer, or artist. However, such term does not include any expense related to printing, photographic plates, motion picture files, video tapes, or similar items.

169 The $15 million gross receipts test is described in section III.B.2. of this document (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships).

170 In the case of a sole proprietorship, the $15 million gross receipts test is applied as if the sole proprietorship were a corporation.

5. Increase in gross receipts test for construction contract exception to percentage of completion method

Present Law

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[171] Under this method, the taxpayer must include in gross income for the taxable year an amount equal to the product of (1) the gross contract price and (2) the percentage of the contract completed during the taxable year.[172] The percentage of the contract completed during the taxable year is determined by comparing costs allocated to the contract and incurred before the end of the taxable year with the estimated total contract costs.[173] Costs allocated to the contract typically include all costs (including depreciation) that directly benefit or are incurred by reason of the taxpayer's long-term contract activities.[174] The allocation of costs to a contract is made in accordance with regulations.[175] Costs incurred with respect to the long-term contract are deductible in the year incurred, subject to general accrual method of accounting principles and limitations.[176]

An exception from the requirement to use the percentage-of-completion method is provided for certain construction contracts ("small construction contracts"). Contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer whose average annual gross receipts for the prior three taxable years do not exceed $10 million.[177] Thus, long-term contract income from small construction contracts must be reported consistently using the taxpayer's exempt contract method.[178] Permissible exempt contract methods include the

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[171] Sec. 460(a).

[172] See Treas. Reg. sec. 1.460-4. This calculation is done on a cumulative basis. Thus, the amount included in gross income in a particular year is that proportion of the expected contract price that the amount of costs incurred through the end of the taxable year bears to the total expected costs, reduced by the amounts of gross contract price included in gross income in previous taxable years.

[173] Sec. 460(b)(1).

[174] Sec. 460(c).

[175] Treas. Reg. sec. 1.460-5.

[176] Treas. Reg. secs. 1.460-4(b)(2)(iv) and 1.460-1(b)(8).

[177] Secs. 460(e)(1)(B) and (4).

[178] Since such contracts involve the construction of real property, they are subject to the interest capitalization rules without regard to their duration. See Treas. Reg. sec. 1.263A-8.

completed contract method, the exempt-contract percentage-of-completion method, the percentage-of-completion method, or any other permissible method.[179]

Description of Proposal

The proposal expands the exception for small construction contracts from the requirement to use the percentage-of-completion method. Under the proposal, contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the taxable year in which the contract was entered into) meets the $15 million gross receipts test.[180]

Effective Date

The proposal applies to contracts entered into after December 31, 2017, in taxable years ending after such date.

Application of this rule is a change in the taxpayer's method of accounting for purposes of section 481, but is applied on a cutoff basis for all similarly classified contracts (hence there is no adjustment under section 481(a) for contracts entered into before January 1, 2018).

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[179] Treas. Reg. sec. 1.460-4(c)(1).

[180] The $15 million gross receipts test is described in section III.B.2. of this document (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships). In the case of a sole proprietorship, the $15 million gross receipts test is applied as if the sole proprietorship were a corporation.

C. Cost Recovery, etc.

1. Limitation on deduction for interest

Present Law

Interest deduction

Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations.[181]

Interest is generally deducted by a taxpayer as it is paid or accrued, depending on the taxpayer's method of accounting. For all taxpayers, if an obligation is issued with original issue discount ("OID"), a deduction for interest is allowable over the life of the obligation on a yield to maturity basis.[182] Generally, OID arises where interest on a debt instrument is not calculated based on a qualified rate and required to be paid at least annually.

Investment interest expense

In the case of a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment ("investment interest") is limited to the taxpayer's net investment income for the taxable year.[183] Disallowed investment interest is carried forward to the next taxable year.

Net investment income is investment income net of investment expenses. Investment income generally consists of gross income from property held for investment, and investment expense includes all deductions directly connected with the production of investment income (*e.g.*, deductions for investment management fees) other than deductions for interest. Investment income includes only so much of the taxpayer's net capital gain and qualified dividend income as the taxpayer elects to take into account as investment income.

The two-percent floor on miscellaneous itemized deductions allows taxpayers to deduct investment expenses connected with investment income only to the extent such deductions

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[181] Sec. 163(a). In addition to the limitations discussed herein, other limitations include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for personal interest (sec. 163(h)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264), and disallowance of deduction for interest relating to tax-exempt income (sec. 265). Interest may also be subject to capitalization. See, *e.g.*, sections 263A(f) and 461(g).

[182] Sec. 163(e). But see section 267 (dealing in part with interest paid to a related or foreign party).

[183] Sec. 163(d).

exceed two percent of the taxpayer's adjusted gross income ("AGI").[184] Miscellaneous itemized deductions[185] that are not investment expenses are disallowed first before any investment expenses are disallowed.[186]

For purposes of the investment interest limitation, debt is allocated under a tracing approach to expenditures in accordance with the use of the debt proceeds, and interest on the debt is allocated in the same manner.[187] Thus, generally, the disallowance of a deduction for investment interest depends on the individual's use of the proceeds of the debt. For example, if an individual pledges corporate stock held for investment as security for a loan and uses the debt proceeds to purchase a car for personal use, interest expense on the debt is allocated to the personal expenditure to purchase the car and is treated as nondeductible personal interest rather than investment interest.

Earnings stripping

Section 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a taxable year if two threshold tests are satisfied: the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio) and the payor's net interest expense exceeds 50 percent of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Disqualified interest includes interest paid or accrued to: (1) related parties when no Federal income tax is imposed with respect to such interest;[188] (2) unrelated parties in certain instances in which a related party guarantees the debt; or (3) to a real estate investment trust ("REIT") by a taxable REIT subsidiary of that trust.[189] Interest amounts disallowed under these rules can be carried forward indefinitely.[190] In addition, any

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184 Sec. 67(a).

185 Miscellaneous itemized deductions include itemized deductions of individuals other than certain specific itemized deductions. Sec. 67(b). Miscellaneous itemized deductions generally include, for example, investment management fees and certain employee business expenses, but specifically do not include, for example, interest, taxes, casualty and theft losses, charitable contributions, medical expenses, or other listed itemized deductions.

186 H.R. Rep. No. 841, 99th Cong., 2d Sess., p. II-154, Sept. 18, 1986 (Conf. Rep.) ("In computing the amount of expenses that exceed the 2-percent floor, expenses that are not investment expenses are intended to be disallowed before any investment expenses are disallowed.").

187 Temp. Treas. Reg. sec. 1.163-8T(c).

188 If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

189 Sec. 163(j)(3).

190 Sec. 163(j)(1)(B).

excess limitation (*i.e.*, the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.[191]

Description of Proposal

In general

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of business interest income plus 30 percent of the adjusted taxable income of the taxpayer for the taxable year. The amount of any interest not allowed as a deduction for any taxable year may be carried forward indefinitely. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, it applies at the consolidated tax return filing level.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the proposal. Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of section 163(d).

By including business interest income in the limitation, the rule operates to limit the deduction for net interest expense to 30 percent of adjusted taxable income. That is, a deduction for business interest is permitted to the full extent of business interest income. To the extent that business interest exceeds business interest income, the deduction for the net interest expense is limited to 30 percent of adjusted taxable income.

Adjusted taxable income means the taxable income of the taxpayer computed without regard to: (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the 17.4 percent deduction for certain pass-through income;[192] and (4) the amount of any net operating loss deduction. The Secretary may provide other adjustments to the computation of adjusted taxable income.

Application to pass-through entities

In general

In the case of any partnership, the limitation is applied at the partnership level. Any deduction for business interest is taken into account in determining the nonseparately stated taxable income or loss of the partnership.[193] To prevent double counting, special rules are

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[191] Sec. 163(j)(2)(B)(ii).

[192] See section I.B.1. of this document (Allow 17.4 percent deduction to certain pass-through income).

[193] This amount is the "Ordinary business income or loss" reflected on Form 1065 (U.S. Return of Partnership Income). The partner's distributive share is reflected in Box 1 of Schedule K-1 (Form 1065).

provided for the determination of the adjusted taxable income of each partner of the partnership. Similarly, to allow for additional interest deduction by a partner in the case of an excess amount of unused adjusted taxable income limitation of the partnership, special rules apply. Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule

The adjusted taxable income of each partner (or shareholder, as the case may be) is determined without regard to such partner's distributive share of the nonseparately stated income or loss of such partnership. In the absence of such a rule, the same dollars of adjusted taxable income of a partnership could generate additional interest deductions as the income is passed through to the partners.

Example 1.−ABC is a partnership owned 50-50 by XYZ Corporation and an individual. ABC generates $200 of noninterest income. Its only expense is $60 of business interest. Under the proposal the deduction for business interest is limited to 30 percent of adjusted taxable income, that is, 30 percent * $200 = $60. ABC deducts $60 of business interest and reports ordinary business income of $140. XYZ's distributive share of the ordinary business income of ABC is $70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of $25. In the absence of a double counting rule, the $70 of taxable income from XYZ's distributive share of ABC's income would permit XYZ to deduct up to an additional $21 of interest (30 percent * $70 = $21), and XYZ's $100 share of ABC's adjusted taxable income would generate $51 of interest deductions, well in excess of the intended 30% limitation. If XYZ were a pass-through entity rather than a corporation, additional deductions might be available to its partners as well, and so on.

The double counting rule prevents this result by providing that XYZ has adjusted taxable income computed without regard to the $70 distributive share of the nonseparately stated income of ABC. As a result it has adjusted taxable income of $0. XYZ's deduction for business interest is limited to 30 percent * $0 = $0, resulting in a deduction disallowance of $25.

Additional deduction limit

The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess taxable income. The excess taxable income with respect to any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership exceeds the business interest income of the partnership bears to 30 percent of the adjusted taxable income of the partnership. This allows a partner of a partnership to deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. The proposal requires that excess taxable income be allocated in the same manner as nonseparately stated income and loss.

Example 2.−The facts are the same as in Example 1 except ABC has only $40 of business interest. As in Example 1, ABC has a limit on its interest deduction of $60. The excess of this

limit over the business interest of the partnership is $60 - $40 = $20. The excess taxable income for ABC is $20 / $60 * $200 = $66.67. XYZ's distributive share of the excess taxable income from ABC partnership is $33.33. XYZ's deduction for business interest is limited to 30 percent of the sum of its adjusted taxable income plus its distributive share of the excess taxable income from ABC partnership (30 percent * ($0 + $33.33) = $10). As a result of the rule, XYZ may deduct $10 of business interest and has an interest deduction disallowance of $15.

Carryforward of disallowed business interest

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward indefinitely. With respect to the limitation on deduction of interest by domestic corporations which are United States shareholders that are members of worldwide affiliated groups with excess domestic indebtedness,[194] whichever rule imposes the lower limitation on the deduction of interest with respect to the taxable year (and therefore the greatest amount of interest to be carried forward) governs.

Any carryforward of disallowed interest is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382.

Exceptions

The limitation does not apply to any taxpayer that meets the $15 million gross receipts test of section 448(c), that is, if the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed $15 million.[195]

The trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. As a result, for example, the wages of an employee are not counted in the adjusted taxable income of the taxpayer for purposes of determining the limitation.

At the taxpayer's election, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses.

The limitation also does not apply to certain regulated public utilities. Specifically, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been

[194] See section IV.D.1. of this document (Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness).

[195] See section III.B.2. of this document (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships). In the case of a sole proprietorship, the $15 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof is not treated as a trade or business for purposes of the limitation.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

2. Temporary 100-percent expensing for certain business assets

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[196] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[197] and convention.[198]

Bonus depreciation

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2020 (January 1, 2021, for longer production period property[199] and certain aircraft[200]).[201] The 50-percent allowance is phased down for property placed in service after December 31, 2017 (after December 31, 2018 for longer production period property and certain aircraft). The bonus depreciation percentage rates are as follows.

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196 See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

197 The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

198 Sec. 168.

199 As defined in section 168(k)(2)(B).

200 As defined in section 168(k)(2)(C).

201 Sec. 168(k). The additional first-year depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A.

Placed in Service Year	**Bonus Depreciation Percentage**	
	Qualified Property in General	**Longer Production Period Property and Certain Aircraft**
2017	50 percent	50 percent
2018	40 percent	50 percent[202]
2019	30 percent	40 percent
2020	n/a	30 percent[203]

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax ("AMT"),[204] but is not allowed in computing earnings and profits.[205] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.[206] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.[207] The taxpayer may elect out of the additional first-year depreciation for any class of property for any taxable year.[208]

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2017 a taxpayer purchases new depreciable property and places it in service.[209] The property's cost is $10,000, and it is five-year property subject to the 200 percent declining balance method and half-year convention. The amount of additional first-year depreciation allowed is $5,000. The remaining $5,000 of the cost of the property is depreciable under the rules applicable to five-year property.

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202 It is intended that for longer production period property placed in service in 2018, 50 percent applies to the entire adjusted basis. Similarly, for longer production period property placed in service in 2019, 40 percent applies to the entire adjusted basis. A technical correction may be necessary with respect to longer production period property placed in service in 2018 and 2019 so that the statute reflects this intent.

203 In the case of longer production period property described in section 168(k)(2)(B) and placed in service in 2020, 30 percent applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2020, and the remaining adjusted basis does not qualify for bonus depreciation. Thirty percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2020.

204 Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)-1(d).

205 Sec. 312(k)(3) and Treas. Reg. sec. 1.168(k)-1(f)(7).

206 Sec. 168(k)(1)(B).

207 *Ibid.*

208 Sec. 168(k)(7). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)-1(e)(2).

209 Assume that the cost of the property is not eligible for expensing under section 179 or Treas. Reg. sec. 1.263(a)-1(f).

Thus, $1,000 also is allowed as a depreciation deduction in 2017.[210] The total depreciation deduction with respect to the property for 2017 is $6,000. The remaining $4,000 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Qualified property

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements.[211] First, the property must be: (1) property to which MACRS applies with an applicable recovery period of 20 years or less; (2) water utility property;[212] (3) computer software other than computer software covered by section 197; or (4) qualified improvement property.[213] Second, the original use[214] of the property must commence with the taxpayer.[215] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2020. As noted above, an extension of the placed-in-service date of one year (*i.e.*, before January 1, 2021) is provided for certain property with a recovery period of 10 years or longer, certain transportation property, and certain aircraft.[216]

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[210] $1,000 results from the application of the half-year convention and the 200 percent declining balance method to the remaining $5,000.

[211] Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

[212] As defined in section 168(e)(5).

[213] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i).

[214] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)-1(b)(3).

[215] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii) and (iii).

[216] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

To qualify, property must be acquired (1) before January 1, 2020, or (2) pursuant to a binding written contract which was entered into before January 1, 2020. With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2020.[217] Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.[218] For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2020 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[219]

Qualified improvement property

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.[220] Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Election to accelerate AMT credits in lieu of bonus depreciation

A corporation otherwise eligible for additional first-year depreciation may elect to claim additional AMT credits in lieu of claiming additional depreciation with respect to qualified property.[221] In the case of a corporation making this election, the straight line method is used for the regular tax and the AMT with respect to qualified property.[222]

A corporation making an election increases the tax liability limitation under section 53(c) on the use of minimum tax credits by the bonus depreciation amount. The aggregate increase in credits allowable by reason of the increased limitation is treated as refundable.

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[217] Sec. 168(k)(2)(E)(i).

[218] Treas. Reg. sec. 1.168(k)-1(b)(4)(iii).

[219] Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

[220] Sec. 168(k)(3).

[221] Sec. 168(k)(4).

[222] Sec. 168(k)(4)(A)(ii).

The bonus depreciation amount generally is equal to 20 percent of bonus depreciation for qualified property that could be claimed as a deduction absent an election under this provision.[223] As originally enacted, the bonus depreciation amount for all taxable years was limited to the lesser of (1) $30 million or (2) six percent of the minimum tax credits allocable to the adjusted net minimum tax imposed for taxable years beginning before January 1, 2006. However, extensions of this provision have provided that this limitation applies separately to property subject to each extension.

For taxable years ending after December 31, 2015, the bonus depreciation amount for a taxable year (as defined under present law with respect to all qualified property) is limited to the lesser of (1) 50 percent of the minimum tax credit for the first taxable year ending after December 31, 2015 (determined before the application of any tax liability limitation) or (2) the minimum tax credit for the taxable year allocable to the adjusted net minimum tax imposed for taxable years ending before January 1, 2016 (determined before the application of any tax liability limitation and determined on a first-in, first-out basis).

All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.[224]

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, bonus depreciation does not apply to any qualified property and the straight line method is used with respect to that property.[225]

In the case of a partnership having a single corporate partner owning (directly or indirectly) more than 50 percent of the capital and profits interests in the partnership, each partner takes into account its distributive share of partnership depreciation in determining its bonus depreciation amount.[226]

Special rules

Passenger automobiles

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year

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[223] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation determined if section 168(k)(1) applied to all qualified property placed in service during the taxable year and (ii) the amount of depreciation that would be so determined if section 168(k)(1) did not so apply. This determination is made using the most accelerated depreciation method and the shortest life otherwise allowable for each property.

[224] Sec. 168(k)(4)(B)(iii).

[225] Sec. 168(k)(4)(D)(ii).

[226] Sec. 168(k)(4)(D)(iii).

deduction).[227] The $8,000 amount is phased down from $8,000 by $1,600 per calendar year beginning in 2018. Thus, the section 280F increase amount for property placed in service during 2018 is $6,400, and during 2019 is $4,800. While the underlying section 280F limitation is indexed for inflation,[228] the section 280F increase amount is not indexed for inflation. The increase does not apply to a taxpayer who elects to accelerate AMT credits in lieu of bonus depreciation for a taxable year.

Certain plants bearing fruits and nuts

A special election is provided for certain plants bearing fruits and nuts.[229] Under the election, the applicable percentage of the adjusted basis of a specified plant which is planted or grafted after December 31, 2015, and before January 1, 2020, is deductible for regular tax and AMT purposes in the year planted or grafted by the taxpayer, and the adjusted basis is reduced by the amount of the deduction.[230] The percentage is 50 percent for 2017, 40 percent for 2018, and 30 percent for 2019. A specified plant is any tree or vine that bears fruits or nuts, and any other plant that will have more than one yield of fruits or nuts and generally has a preproductive period of more than two years from planting or grafting to the time it begins bearing fruits or nuts.[231] The election is revocable only with the consent of the Secretary, and if the election is made with respect to any specified plant, such plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.

Long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[232] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service before January 1, 2020 (January 1, 2021, in the case of longer production period property).[233]

Description of Proposal

The proposal extends and modifies the additional first-year depreciation deduction through 2022 (through 2023 for longer production period property and certain aircraft). The 50-

[227] Sec. 168(k)(2)(F).

[228] Sec. 280F(d)(7).

[229] See sec. 168(k)(5).

[230] Any amount deducted under this election is not subject to capitalization under section 263A.

[231] A specified plant does not include any property that is planted or grafted outside the United States.

[232] Sec. 460.

[233] Sec. 460(c)(6). Other dates involving prior years are not described herein.

percent allowance is increased to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. Thus, the proposal repeals the phase-down of the additional first-year depreciation deduction for property placed in service after December 31, 2017, and for specified plants planted or grafted after such date. Similarly, the proposal maintains the section 280F increase amount of $8,000 for passenger automobiles placed in service after December 31, 2017.

The proposal excludes from the definition of qualified property certain public utility property, *i.e.*, property used predominantly in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.[234]

As a conforming amendment to the repeal of AMT, the proposal repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Effective Date

The proposal generally applies to property placed in service after September 27, 2017, and to specified plants planted or grafted after such date.

A transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply a 50-percent allowance.

3. Modifications to depreciation limitations on luxury automobiles and personal use property

Present Law

Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles. This limitation is commonly referred to as the "luxury automobile depreciation limitation." For passenger automobiles placed in service in 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period.[235] This limitation is indexed for inflation and applies to the aggregate deduction provided under present law for depreciation and section 179 expensing. Hence, passenger automobiles subject to section 280F are eligible for section 179 expensing only to the extent of the applicable limits contained in section 280F. For passenger automobiles eligible for

[234] As defined in section 168(i)(10) without regard to subparagraph (C) of such section.

[235] Rev. Proc. 2017-29, Table 3, 2017-14 I.R.B. 1065.

the additional first-year depreciation allowance in 2017, the first-year limitation is increased by an additional $8,000.[236]

For purposes of the depreciation limitation, passenger automobiles are defined broadly to include any four-wheeled vehicles that are manufactured primarily for use on public streets, roads, and highways and which are rated at 6,000 pounds unloaded gross vehicle weight or less.[237] In the case of a truck or a van, the depreciation limitation applies to vehicles that are rated at 6,000 pounds gross vehicle weight or less. Sport utility vehicles are treated as a truck for the purpose of applying the section 280F limitation.

Basis not recovered in the recovery period of a passenger automobile is allowable as an expense in subsequent taxable years.[238] The expensed amount is limited in each such subsequent taxable year to the amount of the limitation in the fourth year in the recovery period.

Listed property

In the case of certain listed property, special rules apply. Listed property generally is defined as (1) any passenger automobile; (2) any other property used as a means of transportation;[239] (3) any property of a type generally used for purposes of entertainment, recreation, or amusement; (4) any computer or peripheral equipment;[240] and (5) any other property of a type specified in Treasury regulations.[241]

First, if for the taxable year in which the property is placed in service, the use of the property for trade or business purposes does not exceed 50 percent of the total use of the property, then the depreciation deduction with respect to such property is determined under the alternative depreciation system.[242] The alternative depreciation system generally requires the use

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[236] Sec. 168(k)(2)(F). For proposed changes to section 168(k), see section III.C.2. of this document (Temporary 100-percent expensing for certain business assets).

[237] Sec. 280F(d)(5). Exceptions are provided for any ambulance, hearse, or combination ambulance-hearse used by the taxpayer directly in a trade or business, or any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire.

[238] Sec. 280F(a)(1)(B).

[239] Property substantially all of the use of which is in a trade or business of providing transportation to unrelated persons for hire is not considered other property used as a means of transportation. Sec. 280F(d)(4)(C).

[240] Computer or peripheral equipment used exclusively at a regular business establishment and owned or leased by the person operating such establishment, however, is not listed property. Sec. 280F(d)(4)(B).

[241] Sec. 280F(d)(4)(A).

[242] Sec. 280F(b)(1). If for any taxable year after the year in which the property is placed in service the use of the property for trade or business purposes decreases to 50 percent or less of the total use of the property, then the amount of depreciation allowed in prior years in excess of the amount of depreciation that would have been allowed for such prior years under the alternative depreciation system is recaptured (*i.e.*, included in gross income) for such taxable year.

of the straight-line method and a recovery period equal to the class life of the property.[243] Second, if an individual owns or leases listed property that is used by the individual in connection with the performance of services as an employee, no depreciation deduction, expensing allowance, or deduction for lease payments is available with respect to such use unless the use of the property is for the convenience of the employer and required as a condition of employment.[244] Both limitations apply for purposes of section 179 expensing.

For listed property, no deduction is allowed unless the taxpayer adequately substantiates the expense and business usage of the property.[245] A taxpayer must substantiate the elements of each expenditure or use of listed property, including (1) the amount (*e.g.*, cost) of each separate expenditure and the amount of business or investment use, based on the appropriate measure (*e.g.*, mileage for automobiles), and the total use of the property for the taxable period, (2) the date of the expenditure or use, and (3) the business purposes for the expenditure or use.[246] The level of substantiation for business or investment use of listed property varies depending on the facts and circumstances. In general, the substantiation must contain sufficient information as to each element of every business or investment use.[247]

Description of Proposal

The proposal increases the depreciation limitations under section 280F that apply to listed property. For passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period.[248] The limitations are indexed for inflation for passenger automobiles placed in service after 2018.

The proposal removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the heightened substantiation requirements that apply to listed property.

Effective Date

The proposal is effective for property placed in service after December 31, 2017.

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[243] Sec. 168(g).

[244] Sec. 280F(d)(3).

[245] Sec. 274(d)(4).

[246] Temp. Reg. sec. 1.274-5T(b)(6).

[247] Temp. Reg. sec. 1.274-5T(c)(2)(ii)(C).

[248] Rev. Proc. 2017-29, Table 3, 2017-14 I.R.B. 1065.

4. Modifications of treatment of certain farm property

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[249] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[250]

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.[251] The "type of property" of an asset is used to determine the "class life" of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,[252] switching to the straight line method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method is required for the aforementioned real property.

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[249] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

[250] Sec. 168.

[251] Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[252] Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of $1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method.

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent declining balance	285.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight-line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00

Property used in a farming business is assigned various recovery periods in the same manner as other business property. For example, depreciable assets used in agriculture activities that are assigned a recovery period of 7 years include machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services.[253] Cotton ginning assets are also assigned a recovery period of 7 years,[254] while land improvements such as drainage facilities, paved lots, and water wells are assigned a recovery period of 15 years.[255] A 5-year recovery period was assigned to new farm machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which was used in a farming business,[256] the original use of which commenced with the taxpayer after December 31, 2008, and which was placed in service before January 1, 2010.[257]

Any property (other than nonresidential real property,[258] residential rental property,[259] and trees or vines bearing fruits or nuts[260]) used in a farming business[261] is subject to the 150-percent declining balance method.[262]

Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures are required to depreciate all farming assets using the alternative depreciation system (*i.e.*, using longer recovery periods and the straight line method).[263]

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[253] Rev. Proc. 87-56, Asset class 01.1, Agriculture.

[254] Rev. Proc. 87-56, Asset class 01.11, Cotton ginning assets.

[255] Rev. Proc. 87-56, Asset class 00.3, Land improvements. *See also*, IRS Publication 225, Farmer's Tax Guide (2017).

[256] As defined in section 263A(e)(4).

[257] Sec. 168(e)(3)(B)(vii).

[258] Sec. 168(b)(3)(A).

[259] Sec. 168(b)(3)(B).

[260] Sec. 168(b)(3)(E).

[261] Within the meaning of section 263A(e)(4).

[262] Sec. 168(b)(2)(B).

[263] Sec. 263A(d)(3) and (e)(2).

Description of Proposal

The proposal shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer and is placed in service after December 31, 2017.

The proposal also repeals the required use of the 150-percent declining balance method for property used in a farming business (*i.e.*, for 3-, 5-, 7-, and 10-year property). The 150-percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method.

Effective Date

The proposal is effective for property placed in service after December 31, 2017.

5. Modification of net operating loss deduction

Present Law

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income.[264] In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[265] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[266]

Different carryback periods apply with respect to NOLs arising in different circumstances. Extended carryback periods are allowed for NOLs attributable to specified liability losses and certain casualty and disaster losses.[267] Limitations are placed on the carryback of excess interest losses attributable to corporate equity reduction transactions.[268]

Description of Proposal

The proposal limits the NOL deduction to 90 percent of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and may be carried forward indefinitely.

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[264] Sec. 172(c).

[265] Sec. 172(b)(1)(A).

[266] Sec. 172(b)(2).

[267] Sec. 172(b)(1)(C) and (E).

[268] Sec. 172(b)(1)(D).

The proposal repeals the two-year carryback and the special carryback provisions, but provides a two-year carryback in the case of certain losses incurred in the trade or business of farming.

Effective Date

The proposal allowing indefinite carryovers and modifying carrybacks applies to losses arising in taxable years beginning after December 31, 2017.

The proposal limiting the NOL deduction applies to losses arising in taxable years beginning after December 31, 2017.

6. Like-kind exchanges of real property

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" which is to be held for productive use in a trade or business or for investment.[269] In general, section 1031 does not apply to any exchange of stock in trade (*i.e.*, inventory) or other property held primarily for sale; stocks, bonds, or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[270] Section 1031 also does not apply to certain exchanges involving livestock[271] or foreign property.[272]

For purposes of section 1031, the determination of whether property is of a "like kind" relates to the nature or character of the property and not its grade or quality, *i.e.*, the nonrecognition rules do not apply to an exchange of one class or kind of property for property of a different class or kind (*e.g.*, section 1031 does not apply to an exchange of real property for personal property).[273] The different classes of property are: (1) depreciable tangible personal

[269] Sec. 1031(a)(1).

[270] Sec. 1031(a)(2). A chose in action is a right that can be enforced by legal action.

[271] Sec. 1031(e).

[272] Sec. 1031(h).

[273] Treas. Reg. sec. 1.1031(a)-1(b).

property;[274] (2) intangible or nondepreciable personal property;[275] and (3) real property.[276] However, the rules with respect to whether real estate is "like kind" are applied more liberally than the rules governing like-kind exchanges of depreciable, intangible, or nondepreciable personal property. For example, improved real estate and unimproved real estate generally are considered to be property of a "like kind" as this distinction relates to the grade or quality of the real estate,[277] while depreciable tangible personal properties must be either within the same General Asset Class[278] or within the same Product Class.[279]

The nonrecognition of gain in a like-kind exchange applies only to the extent that like-kind property is received in the exchange. Thus, if an exchange of property would meet the requirements of section 1031, but for the fact that the property received in the transaction consists not only of the property that would be permitted to be exchanged on a tax-free basis, but also other non-qualifying property or money ("additional consideration"), then the gain to the recipient of the other property or money is required to be recognized, but not in an amount

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[274] For example, an exchange of a personal computer classified under asset class 00.12 of Rev. Proc. 87-56, 1987-2 C.B. 674, for a printer classified under the same asset class of Rev. Proc. 87-56 would be treated as property of a like kind. However, an exchange of an airplane classified under asset class 00.21 of Rev. Proc. 87-56 for a heavy general purpose truck classified under asset class 00.242 of Rev. Proc. 87-56 would not be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)-2(b)(7).

[275] For example, an exchange of a copyright on a novel for a copyright on a different novel would be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)-2(c)(3). However, the goodwill or going concern value of one business is not of a like kind to the goodwill or going concern value of a different business. See Treas. Reg. sec. 1.1031(a)-2(c)(2). The Internal Revenue Service ("IRS") has ruled that intangible assets such as trademarks, trade names, mastheads, and customer-based intangibles that can be separately described and valued apart from goodwill qualify as property of a like kind under section 1031. See Chief Counsel Advice 200911006, February 12, 2009.

[276] Treas. Reg. sec. 1.1031(a)-1(b) and (c).

[277] Treas. Reg. sec. 1.1031(a)-1(b).

[278] Treasury Regulation section 1.1031(a)-2(b)(2) provides the following list of General Asset Classes, based on asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87-56, 1987-2 C.B. 674: (i) Office furniture, fixtures, and equipment (asset class 00.11), (ii) Information systems (computers and peripheral equipment) (asset class 00.12), (iii) Data handling equipment, except computers (asset class 00.13), (iv) Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21), (v) Automobiles, taxis (asset class 00.22), (vi) Buses (asset class 00.23), (vii) Light general purpose trucks (asset class 00.241), (viii) Heavy general purpose trucks (asset class 00.242), (ix) Railroad cars and locomotives, except those owned by railroad transportation companies (asset class 00.25), (x) Tractor units for use over-the-road (asset class 00.26), (xi) Trailers and trailer-mounted containers (asset class 00.27), (xii) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction (asset class 00.28), and (xiii) Industrial steam and electric generation and/or distribution systems (asset class 00.4).

[279] Property within a product class consists of depreciable tangible personal property that is described in a 6-digit product class within Sectors 31, 32, and 33 (pertaining to manufacturing industries) of the North American Industry Classification System ("NAICS"), set forth in Executive Office of the President, Office of Management and Budget, *North American Industry Classification System*, United States, 2002 (NAICS Manual), as periodically updated. Treas. Reg. sec. 1.1031(a)-2(b)(3).

exceeding the fair market value of such other property or money.[280] Additionally, any such gain realized on a section 1031 exchange as a result of additional consideration being involved constitutes ordinary income to the extent that the gain is subject to the recapture provisions of sections 1245 and 1250.[281] No losses may be recognized from a like-kind exchange.[282]

If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred. This basis is increased to the extent of any gain recognized as a result of the receipt of other property or money in the like-kind exchange, and decreased to the extent of any money received by the taxpayer.[283] The holding period of qualifying property received includes the holding period of the qualifying property transferred, but the nonqualifying property received is required to begin a new holding period.[284]

A like-kind exchange also does not require that the properties be exchanged simultaneously. Rather, the property to be received in the exchange must be received not more than 180 days after the date on which the taxpayer relinquishes the original property (but in no event later than the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the transfer of the relinquished property occurs). In addition, the taxpayer must identify the property to be received within 45 days after the date on which the taxpayer transfers the property relinquished in the exchange.[285]

The Treasury Department has issued regulations[286] and revenue procedures[287] providing guidance and safe harbors for taxpayers engaging in deferred like-kind exchanges.

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[280] Sec. 1031(b). For example, if a taxpayer holding land A having a basis of $40,000 and a fair market value of $100,000 exchanges the property for land B worth $90,000 plus $10,000 in cash, the taxpayer would recognize $10,000 of gain on the transaction, which would be includable in income. The remaining $50,000 of gain would be deferred until the taxpayer disposes of land B in a taxable sale or exchange.

[281] Secs. 1245(b)(4) and 1250(d)(4). For example, if a taxpayer holding section 1245 property A with an original cost basis of $11,000, an adjusted basis of $10,000, and a fair market value of $15,000 exchanges the property for section 1245 property B with a fair market value of $14,000 plus $1,000 in cash, the taxpayer would recognize $1,000 of ordinary income on the transaction. The remaining $4,000 of gain would be deferred until the taxpayer disposes of section 1245 property B in a taxable sale or exchange.

[282] Sec. 1031(c).

[283] Sec. 1031(d). Thus, in the example noted above, the taxpayer's basis in B would be $40,000 (the taxpayer's transferred basis of $40,000, increased by $10,000 in gain recognized, and decreased by $10,000 in money received).

[284] Sec. 1223(1).

[285] Sec. 1031(a)(3).

[286] Treas. Reg. sec. 1.1031(k)-1(a) through (o).

[287] See Rev. Proc. 2000-37, 2000-40 I.R.B. 308, as modified by Rev. Proc. 2004-51, 2004-33 I.R.B. 294.

Description of Proposal

The proposal modifies the provision providing for nonrecognition of gain in the case of like-kind exchanges by limiting its application to real property that is not held primarily for sale.

Effective Date

The proposal generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before such date.

7. Applicable recovery period for real property

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[288] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[289]

Recovery periods and depreciation methods

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.[290] The "type of property" of an asset is used to determine the "class life" of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,[291] switching to the straight line

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[288] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

[289] Sec. 168.

[290] Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[291] Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the

method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method is required for the aforementioned real property.

Placed-in-service conventions

Depreciation of an asset begins when the asset is deemed to be placed in service under the applicable convention.[292] Under MACRS, nonresidential real property, residential rental property, and any railroad grading or tunnel bore generally are subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.[293] All other property generally is subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year to reflect the assumption that assets are placed in service ratably throughout the year.[294] However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention,[295] designed to prevent the recognition of disproportionately large amounts of first-year depreciation under the half-year convention.

Depreciation of additions or improvements to property

The recovery period for any addition or improvement to real or personal property begins on the later of (1) the date on which the addition or improvement is placed in service, or (2) the date on which the property with respect to which such addition or improvement is made is placed in service.[296] Any MACRS deduction for an addition or improvement to any property is to be

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declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of $1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method.

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent declining balance	285.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight-line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00

292 Treas. Reg. sec. 1.167(a)-10(b).

293 Sec. 168(d)(2) and (d)(4)(B).

294 Sec. 168(d)(1) and (d)(4)(A).

295 The mid-quarter convention treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Sec. 168(d)(3) and (d)(4)(C).

296 Sec. 168(i)(6).

computed in the same manner as the deduction for the underlying property would be if such property were placed in service at the same time as such addition or improvement. Thus, for example, the cost of an improvement to a building that constitutes nonresidential real property is recovered over 39 years using the straight line method and mid-month convention. Certain improvements to nonresidential real property are eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met (*i.e.*, improvements that constitute "qualified improvement property").[297]

Qualified improvement property

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.[298] Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease.[299] This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions to the 39-year recovery period exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[300] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural

[297] Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See also section III.C.2. of this document (Temporary 100-percent expensing for certain business assets).

[298] Sec. 168(k)(3).

[299] Sec. 168(i)(8).

[300] Sec. 168(e)(6).

component benefiting a common area, or the internal structural framework of the building. If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention,[301] and is eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met.[302]

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.[303] Qualified restaurant property is recovered using the straight-line method and a half-year convention.[304] Additionally, qualified restaurant property is not eligible for the additional first-year depreciation deduction unless it also satisfies the definition of qualified improvement property.[305]

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[306] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[307] Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the

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301 Sec. 168(b)(3)(G) and (d).

302 Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See section III.C.2. of this document (Temporary 100-percent expensing for certain business assets).

303 Sec. 168(e)(7).

304 Sec. 168(b)(3)(H) and (d).

305 Sec. 168(e)(7)(B).

306 Improvements to portions of a building not open to the general public (*e.g.*, stock room in back of retail space) do not qualify under the provision.

307 Sec. 168(e)(8).

internal structural framework of the building.[308] In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.[309]

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.[310]

Qualified retail improvement property is recovered using the straight-line method and a half-year convention,[311] and is eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met.[312]

Alternative depreciation system

The alternative depreciation system ("ADS") is required to be used for tangible property used predominantly outside the United States, certain tax-exempt use property, tax-exempt bond financed property, and certain imported property covered by an Executive order.[313] An election to use ADS is available to taxpayers for any class of property for any taxable year.[314] Under ADS, all property is depreciated using the straight line method over recovery periods which generally are equal to the class life of the property, with certain exceptions.[315]

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308 Sec. 168(e)(8)(C).

309 Sec. 168(e)(8)(B). Rules similar to section 168(e)(6)(B) apply in the case of death and certain transfers of property that qualify for non-recognition treatment.

310 Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress* (JCS-1-09), March 2009, p. 402.

311 Sec. 168(b)(3)(I) and (d).

312 Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See section III.C.2. of this document (Temporary 100-percent expensing for certain business assets).

313 Sec. 168(g).

314 Sec. 168(g)(7).

315 Sec. 168(g)(2).

Description of Proposal

The proposal shortens the recovery period for determining the depreciation deduction with respect to nonresidential real and residential rental property to 25 years. As a conforming amendment, the proposal changes the statutory recovery period for nonresidential real and residential rental property to 25 years for purposes of determining whether a rental agreement is a long-term agreement under the section 467 rules applicable to certain payments for the use of property or services.[316]

The proposal eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 10-year recovery period for qualified improvement property,[317] and a 20-year ADS recovery period for such property. Thus, for example, qualified improvement property placed in service after December 31, 2017, is generally depreciable over 10 years using the straight line method and half-year convention, without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after December 31, 2017, that does not meet the definition of qualified improvement property is depreciable over 25 years as nonresidential real property, using the straight line method and the mid-month convention.

As a conforming amendment, the proposal replaces the references in section 179(f) to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property with a reference to qualified improvement property.[318] Thus, for example, the proposal allows section 179 expensing for improvement property without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after December 31, 2017, that does not meet the definition of qualified improvement property is not eligible for section 179 expensing.

The proposal also requires a real property trade or business[319] electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property.

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[316] A long-term section 467 rental agreement is a lease of property for a term in excess of 75 percent of the property's statutory recovery period. Sec. 467(b)(4)(A) and (e)(3)(A). A disqualified long-term agreement is one that has as one of its principal purposes the avoidance of taxes. Sec. 467(b)(4)(B).

[317] Described in section 168(k)(3).

[318] For additional proposed changes to section 179, see section III.B.1. of this document (Modification of rules for expensing depreciable business assets).

[319] As defined in section III.C.1. of this document (Limitation on deduction for interest), by cross reference to section 469(c)(7)(C) (*i.e.*, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business). Note that a

Effective Date

The proposal is effective for property placed in service after December 31, 2017.

mortgage broker who is a broker of financial instruments is not in a real property trade or business for this purpose. See, *e.g.*, CCA 201504010 (December 17, 2014).

D. Business-Related Deductions

1. Repeal of deduction for income attributable to domestic production activities

Present Law

Section 199 provides a deduction from taxable income (or, in the case of an individual, adjusted gross income[320]) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income (determined without regard to the section 199 deduction) for the taxable year.[321] For corporations subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.[322] A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.[323]

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[324] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States;[325] (2) any sale, exchange, or

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[320] For this purpose, adjusted gross income is determined after application of sections 86, 135, 137, 219, 221, 222, and 469, without regard to the section 199 deduction. Sec. 199(d)(2).

[321] Sec. 199(a). In the case of oil related qualified production activities income, the deduction from taxable income is equal to six percent of the lesser of the taxpayer's oil related qualified production activities income, qualified production activities income, or taxable income. Sec. 199(d)(9).

[322] This example assumes the deduction does not exceed the wage limitation discussed below.

[323] Sec. 199(c)(1). In computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction. Sec. 199(c)(1)(B)(ii). See Treas. Reg. secs. 1.199-1 through 1.199-9 where the Secretary has prescribed rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income.

[324] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings. Sec. 199(c)(5).

[325] When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia. Sec. 7701(a)(9). A special rule for determining domestic production gross receipts, however, provides that for taxable years beginning after December 31, 2005, and before January 1, 2017, in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations for such taxable year. Secs. 199(d)(8)(A) and (C). In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico. Sec. 199(d)(8)(B).

other disposition, or any lease, rental, or license, of qualified film[326] produced by the taxpayer; (3) any sale, exchange, or other disposition, or any lease, rental, or license, of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.[327]

The amount of the deduction for a taxable year is limited to 50 percent of the W-2 wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[328]

Description of Proposal

The proposal repeals the deduction for income attributable to domestic production activities.

Effective Date

The proposal applies to taxable years beginning after December 31, 2018.

2. Limitation on deduction by employers of expenses for fringe benefits

Present Law

In general

No deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation ("entertainment"), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (*e.g.*, an airplane) used in connection with such

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[326] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers. Sec. 199(c)(6).

[327] Sec. 199(c)(4)(A).

[328] Sec. 199(b)(1). For purposes of the provision, "W-2 wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions as defined in section 402A. See sec. 199(b)(2)(A). The wage limitation for qualified films includes any compensation for services performed in the United States by actors, production personnel, directors, and producers and is not restricted to W-2 wages. Sec. 199(b)(2)(D).

activity.[329] If the taxpayer establishes that entertainment expenses are directly related to (or associated with) the active conduct of its trade or business, the deduction generally is limited to 50 percent of the amount otherwise deductible.[330] Similarly, a deduction for any expense for food or beverages generally is limited to 50 percent of the amount otherwise deductible.[331] In addition, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation, or other social purpose.[332]

There are a number of exceptions to the general rule disallowing deduction of entertainment expenses and the rules limiting deductions to 50 percent of the otherwise deductible amount. Under one such exception, those rules do not apply to expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and as wages to an employee.[333] Those rules also do not apply to expenses for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient who is not an employee (*e.g.*, a nonemployee director) as compensation for services rendered or as a prize or award.[334] The exceptions apply only to the extent that amounts are properly reported by the company as compensation and wages or otherwise includible in income. In no event can the amount of the deduction exceed the amount of the taxpayer's actual cost, even if a greater amount (*i.e.*, fair market value) is includible in income.[335]

Those deduction disallowance rules also do not apply to expenses paid or incurred by the taxpayer, in connection with the performance of services for another person (other than an employer), under a reimbursement or other expense allowance arrangement if the taxpayer accounts for the expenses to such person.[336] Another exception applies for expenses for recreational, social, or similar activities primarily for the benefit of employees other than certain owners and highly compensated employees.[337] An exception applies also to the 50 percent

[329] Sec. 274(a)(1).

[330] Sec. 274(n)(1)(B).

[331] Sec. 274(n)(1)(A).

[332] Sec. 274(a)(3).

[333] Sec. 274(e)(2)(A). See below for a discussion of the recent modification of this rule for certain individuals.

[334] Sec. 274(e)(9).

[335] Treas. Reg. sec. 1.162-25T(a).

[336] Sec. 274(e)(3).

[337] Sec. 274(e)(4).

deduction limit for food and beverages provided to crew members of certain commercial vessels and certain oil or gas platform or drilling rig workers.[338]

Expenses treated as compensation

Except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.[339] In general, an employee (or other service provider) must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount (if any) paid by the individual and the amount (if any) specifically excluded from gross income.[340] Treasury regulations provide detailed rules regarding the valuation of certain fringe benefits, including flights on an employer-provided aircraft. In general, the value of a non-commercial flight generally is determined under the base aircraft valuation formula, also known as the Standard Industry Fare Level formula or "SIFL."[341] If the SIFL valuation rules do not apply, the value of a flight on an employer-provided aircraft generally is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable aircraft for that period for the same or a comparable flight.[342]

In the context of an employer providing an aircraft to employees for nonbusiness (*e.g.*, vacation) flights, the exception for expenses treated as compensation has been interpreted as not limiting the company's deduction for expenses attributable to the operation of the aircraft to the amount of compensation reportable to its employees.[343] The result of that interpretation is often a deduction several times larger than the amount required to be included in income. Further, in many cases, the individual including amounts attributable to personal travel in income directly benefits from the enhanced deduction, resulting in a net deduction for the personal use of the company aircraft.

The exceptions for expenses treated as compensation or otherwise includible income were subsequently modified in the case of specified individuals such that the exceptions apply only to the extent of the amount of expenses treated as compensation or includible in income of the specified individual.[344] Specified individuals are individuals who, with respect to an employer or other service recipient (or a related party), are subject to the requirements of

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[338] Sec. 274(n)(2)(E).

[339] Sec. 61(a)(1).

[340] Treas. Reg. sec. 1.61-21(b)(1).

[341] Treas. Reg. sec. 1.61-21(g)(5).

[342] Treas. Reg. sec. 1.61-21(b)(6).

[343] *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 197 (2000), aff'd, 255 F.3d 495 (8th Cir. 2001).

[344] Sec. 274(e)(2)(B)(i). See also Treas. Reg. sec. 1.274-9(a).

section 16(a) of the Securities Exchange Act of 1934, or would be subject to such requirements if the employer or service recipient (or related party) were an issuer of equity securities referred to in section 16(a).[345]

As a result, in the case of specified individuals, no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (*e.g.*, an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income to the specified individual. For example, a company's deduction attributable to aircraft operating costs and other expenses for a specified individual's vacation use of a company aircraft is limited to the amount reported as compensation to the specified individual. However, in the case of other employees or service providers, the company's deduction is not limited to the amount treated as compensation or includible in income.[346]

Excludable fringe benefits

Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including, but not limited to, de minimis fringes, qualified transportation fringes, and meals provided for the "convenience of the employer."[347]

A de minimis fringe generally means any property or service the value of which is (taking into account the frequency with which similar fringes are provided by the employer) so small as to make accounting for it unreasonable or administratively impracticable,[348] and also includes food and beverages provided to employees through an eating facility operated by the employer that is located on or near the employer's business premises and meets certain requirements.[349]

Qualified transportation fringes include qualified parking (parking on or near the employer's business premises or on or near a location from which the employee commutes to

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[345] Sec. 274(e)(2)(B)(ii). See also Treas. Reg. sec. 1.274-9(b).

[346] See Treas. Reg. sec. 1.274-10(a)(2).

[347] Secs. 132(a), 119(a), 3121(a)(19) and (20), 3231(e)(5) and (9), 3306(b)(14) and (16), and 3401(a)(19).

[348] Sec. 132(e)(1). Examples include occasional personal use of an employer's copying machine, occasional parties or meals for employees and their guests, local telephone calls, and coffee, doughnuts and soft drinks. Treas. Reg. sec. 1.132-6(e)(1).

[349] Sec. 132(e)(2). Revenue derived from such a facility must normally equal or exceed the direct operating costs of the facility. Employees who are entitled, under Section 119, to exclude the value of a meal provided at such a facility are treated as having paid an amount for the meal equal to the direct operating costs of the facility attributable to such meal.

work by public transit), transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.[350]

The value of meals furnished to an employee or the employee's spouse or dependents by or on behalf of an employer for the convenience of the employer is excludible from the employee's gross income, but only if such meals are provided on the employer's business premises.[351]

Description of Proposal

The proposal provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items. Thus, the proposal repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions).

While taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (*e.g.*, meals consumed by employees on work travel), the proposal expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes.

In addition, the proposal disallows a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017.

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[350] Sec. 132(f)(1), (5). The qualified transportation fringe exclusions are subject to monthly limits. Sec. 132(f)(2).

[351] Sec. 119(a).

E. Accounting Methods

1. Certain special rules for taxable year of inclusion

Present Law

In general

A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting.[352] If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.[353]

In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received. For an accrual basis taxpayer, an amount is included in income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy, unless an exception permits deferral or exclusion.[354]

A number of exceptions that exist to permit deferral of income relate to advance payments. An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (*e.g.*, income is recognized as the goods are provided or the services are performed).[355]

Interest income

A taxpayer generally must include in gross income the amount of interest received or accrued within the taxable year on indebtedness held by the taxpayer.[356]

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[352] Sec. 451(a).

[353] See Treas. Reg. sec. 1.451-2.

[354] See Treas. Reg. sec. 1.451-1(a).

[355] For examples of provisions permitting deferral of advance payments, see Treas. Reg. sec. 1.451-5 and Rev. Proc. 2004-34, 2004-1 C.B. 991, as modified and clarified by Rev. Proc. 2011-18, 2011-5 I.R.B. 443, and Rev. Proc. 2013-29, 2013-33 I.R.B. 141.

[356] Secs. 61(a)(4) and 451.

Original issue discount

The holder of a debt instrument with original issue discount ("OID") generally accrues and includes the OID in gross income as interest over the term of the instrument, regardless of when the stated interest (if any) is paid.[357]

The amount of OID with respect to a debt instrument is the excess of the stated redemption price at maturity over the issue price of the debt instrument.[358] The stated redemption price at maturity is the sum of all payments provided by the debt instrument other than qualified stated interest payments.[359] The holder includes in gross income an amount equal to the sum of the daily portions of the OID for each day during the taxable year the holder held such debt instrument. The daily portion is determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument.[360] The adjustment to the issue price is determined by multiplying the adjusted issue price (*i.e.*, the issue price increased by adjustments prior to the accrual period) by the instrument's yield to maturity, and then subtracting the interest payable during the accrual period. Thus, to compute the amount of OID and the portion of OID allocable to a period, the stated redemption price at maturity and the term must be known. Issuers of OID instruments accrue and deduct the amount of OID as interest expense in the same manner as the holder.[361]

Debt instruments subject to acceleration

Special rules for determining the amount of OID allocated to a period apply to certain instruments that may be subject to prepayment. If a borrower can reduce the yield on a debt by exercising a prepayment option, the OID rules assume that the borrower will prepay the debt.[362] In addition, in the case of (1) any regular interest in a real estate mortgage investment conduit ("REMIC") or qualified mortgages held by a REMIC or (2) any other debt instrument if payments under the instrument may be accelerated by reason of prepayments of other obligations securing the instrument, the daily portions of the OID on such debt instruments are determined by taking into account an assumption regarding the prepayment of principal for such instruments.[363]

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[357] Sec. 1272.

[358] Sec. 1273(a)(1).

[359] Sec. 1273(a)(2) and Treas. Reg. sec. 1.1273-1(b).

[360] Sec. 1272(a)(1) and (3).

[361] Sec. 163(e).

[362] Treas. Reg. sec. 1.1272-1(c)(5).

[363] Sec. 1272(a)(6).

The Taxpayer Relief Act of 1997[364] extended these rules to any pool of debt instruments the payments on which may be accelerated by reason of prepayments.[365] Thus, if a taxpayer holds a pool of credit card receivables that require interest to be paid only if the borrowers do not pay their accounts by a specified date ("grace-period interest"), the taxpayer is required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. Under these rules, certain amounts (other than grace-period interest) related to credit card transactions, such as late-payment fees,[366] cash-advance fees,[367] and interchange fees,[368] have been determined to create OID or increase the amount of OID on the pool of credit card receivables to which the amounts relate.[369]

Description of Proposal

The proposal revises the rules associated with the recognition of income. Specifically, the proposal requires a taxpayer to recognize income no later than the taxable year in which such income is taken into account as income on an applicable financial statement[370] or another financial statement under rules specified by the Secretary, but provides an exception for long-term contract income to which section 460 applies.[371]

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[364] Pub. L. No. 105-34, sec. 1004(a).

[365] Sec. 1272(a)(6)(C)(iii).

[366] Rev. Proc. 2004-33, 2004-1 C.B. 989.

[367] Rev. Proc. 2005-47, 2005-2 C.B. 269.

[368] *Capital One Financial Corp. and Subsidiaries v. Commissioner*, 133 T.C. No. 8 (2009); IRS Chief Counsel Notice CC-2010-018, September 27, 2010.

[369] See also Rev. Proc. 2013-26, 2013-22 I.R.B. 1160, for a safe harbor method of accounting for OID on a pool of credit card receivables for purposes of section 1272(a)(6).

[370] For purposes of the proposal, the term "applicable financial statement" means: (A) a financial statement which is certified as being prepared in accordance with generally accepted accounting principles and which is (i) a 10–K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the United States Securities and Exchange Commission ("SEC"), (ii) an audited financial statement of the taxpayer which is used for (I) credit purposes, (II) reporting to shareholders, partners, or other proprietors, or to beneficiaries, or (III) any other substantial nontax purpose, but only if there is no statement of the taxpayer described in clause (i), or (iii) filed by the taxpayer with any other Federal agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii); (B) a financial statement which is made on the basis of international financial reporting standards and is filed by the taxpayer with an agency of a foreign government which is equivalent to the SEC and which has reporting standards not less stringent than the standards required by such Commission, but only if there is no statement of the taxpayer described in subparagraph (A); or (C) a financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary, but only if there is no statement of the taxpayer described in subparagraph (A) or (B).

[371] For example, under the proposal, any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes.

The proposal also codifies the current deferral method of accounting for advance payments for goods and services provided by the IRS under Revenue Procedure 2004-34.[372] That is, the proposal allows taxpayers to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.[373]

In addition, the proposal directs taxpayers to apply the revenue recognition rules under section 451 before applying the OID rules under section 1272. Thus, for example, to the extent amounts are included in income for financial statement purposes when received (*e.g.*, late-payment fees, cash-advance fees, or interchange fees), such amounts generally are includable in income at such time in accordance with the general recognition principles under section 451.

In the case of any taxpayer required by this proposal to change its method of accounting for its first taxable year beginning after December 31, 2017, such change is treated as initiated by the taxpayer and made with the consent of the Secretary.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017, and application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

[372] 2004-1 C.B. 991, as modified and clarified by Rev. Proc. 2011-18, 2011-5 I.R.B. 443, and Rev. Proc. 2013-29, 2013-33 I.R.B. 141.

[373] Thus, the proposal is intended to override the exception in Treasury Regulation section 1.451-5(c) for inventoriable goods.

F. Business Credits

1. Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions

Present Law

A 50-percent business tax credit is available for qualified clinical testing expenses incurred in the testing of certain drugs to treat rare diseases or conditions.[374] Such drugs are generally referred to as "orphan drugs" and the credit is generally referred to as the "orphan drug credit." Qualified clinical testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration ("FDA") but before the drug has been approved for sale by the FDA.[375] A rare disease or condition is defined as one that (1) affects fewer than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for such disease or condition from sales in the United States of the drug.[376]

Amounts included in computing the credit under this section are excluded from the computation of the research credit under section 41.[377] Deductions allowed to a taxpayer are reduced by an amount equal to 100 percent of the taxpayer's orphan drug credit determined for the taxable year.[378]

Description of Proposal

The proposal limits the orphan drug credit to 50 percent of so much of qualified clinical testing expenses for the taxable year as exceeds 50 percent of the average qualified clinical testing expenses for the three taxable years preceding the taxable year for which the credit is being determined. In the case where there are no qualified clinical expenses during at least one of the three preceding taxable years, the credit is equal to 25 percent of qualified expenses. Aggregation and other special rules similar to those applicable to the research credit apply where there are controlled groups of corporations, estates and trusts claiming the credit, mergers and acquisitions of taxpayers, and short taxable years. Under the proposal, taxpayers may elect a reduced credit in lieu of reducing otherwise allowable deductions in a manner similar to the research credit under section 280C.

In addition, the proposal limits qualified clinical testing expenses to the extent the testing giving rise to such expenses is related to the use of a drug which has previously been approved

[374] Sec. 45C.

[375] Sec. 45C(b).

[376] Sec. 45C(d).

[377] Sec. 45C(c).

[378] Sec. 280C(b).

under section 505 of the Federal Food, Drug, and Cosmetic Act for use in the treatment of any other disease or condition, if all such diseases or conditions in the aggregate (including the rare disease or condition with respect to which the credit is otherwise being determined) affect more than 200,000 persons in the United States.

Effective Date

The proposal applies to amounts paid or incurred in taxable years beginning after December 31, 2017.

2. Modification of rehabilitation credit

Present Law

Section 47 provides a two-tier tax credit for rehabilitation expenditures.

A 20-percent credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure. For this purpose, a certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

A 10-percent credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. A pre-1936 building must meet requirements with respect to retention of existing external walls and internal structural framework of the building in order for expenditures with respect to it to qualify for the 10-percent credit. A building is treated as having met the substantial rehabilitation requirement under the 10-percent credit only if the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) $5,000.

The provision requires the use of straight-line depreciation or the alternative depreciation system in order for rehabilitation expenditures to be treated as qualified under the provision.

Description of Proposal

The proposal repeals the 10-percent credit for pre-1936 buildings. Under the proposal, a 10-percent credit (not 20-percent) is provided for qualified rehabilitation expenditures with respect to a certified historic structure.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2017. A transition rule provides that in the case of qualified rehabilitation expenditures (for either a certified historic structure or a pre-1936 building), with respect to any building owned or leased by the taxpayer at all times on and after January 1, 2018, the 24-month period selected by the taxpayer (under section 47(c)(1)(C)) is to begin not later than the end of the 180-day period beginning on

the date of the enactment of the Act, and the amendments made by the proposal apply to such expenditures paid or incurred after the end of the taxable year in which such 24-month period ends.

3. Repeal of deduction for certain unused business credits

Present Law

The general business credit ("GBC") consists of various individual tax credits allowed with respect to certain qualified expenditures and activities.[379] In general, the various individual tax credits contain provisions that prohibit "double benefits," either by denying deductions in the case of expenditure-related credits or by requiring income inclusions in the case of activity-related credits. Unused credits may be carried back one year and carried forward 20 years.[380]

Section 196 allows a deduction to the extent that certain portions of the GBC expire unused after the end of the carry forward period. In general, 100 percent of the unused credit is allowed as a deduction in the taxable year after such credit expired. However, with respect to the investment credit determined under section 46 (other than the rehabilitation credit) and the research credit determined under section 41(a) (for a taxable year beginning before January 1, 1990), section 196 limits the deduction to 50 percent of such unused credits.[381]

Description of Proposal

This proposal repeals the deduction for certain unused business credits.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[379] Sec. 38.

[380] Sec. 39.

[381] Sec. 196(d).

G. Banks and Financial Instruments

1. Limitation on deduction for FDIC premiums

Present Law

Corporations organized under the laws of any of the 50 States (and the District of Columbia) generally are subject to the U.S. corporate income tax on their worldwide taxable income. The taxable income of a C corporation[382] generally comprises gross income less allowable deductions. A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[383]

Corporations that make a valid election pursuant to section 1362 of subchapter S of the Code, referred to as S corporations, generally are not subject to corporate-level income tax on its items of income and loss. Instead, an S corporation passes through to shareholders its items of income and loss. The shareholders separately take into account their shares of these items on their individual income tax returns.

Banks, thrifts, and credit unions

In general

Financial institutions are subject to the same Federal income tax rules and rates as are applied to other corporations or entities, with specified exceptions.

C corporation banks and thrifts

A bank is generally taxed for Federal income tax purposes as a C corporation. For this purpose a bank generally means a corporation, a substantial portion of whose business is receiving deposits and making loans and discounts, or exercising certain fiduciary powers.[384] A

[382] Corporations subject to tax are commonly referred to as C corporations after subchapter C of the Code, which sets forth corporate tax rules. Certain specialized entities that invest primarily in real estate related assets (real estate investment trusts) or in stock and securities (regulated investment companies) and that meet other requirements, generally including annual distribution of 90 percent of their income, are allowed to deduct their distributions to shareholders, thus generally paying little or no corporate-level tax despite otherwise being subject to subchapter C.

[383] Sec. 162(a). However, certain exceptions apply. No deduction is allowed for (1) any charitable contribution or gift that would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section; (2) any illegal bribe, illegal kickback, or other illegal payment; (3) certain lobbying and political expenditures; (4) any fine or similar penalty paid to a government for the violation of any law; (5) two-thirds of treble damage payments under the antitrust laws; (6) certain foreign advertising expenses; (7) certain amounts paid or incurred by a corporation in connection with the reacquisition of its stock or of the stock of any related person; or (8) certain applicable employee remuneration.

[384] Sec. 581. See also Treas. Reg. sec. 1.581-1(a).

bank for this purpose generally includes domestic building and loan associations, mutual stock or savings banks, and certain cooperative banks that are commonly referred to as thrifts.[385]

S corporation banks

A bank is generally eligible to elect S corporation status under section 1362, provided it meets the other requirements for making this election and it does not use the reserve method of accounting for bad debts as described in section 585.[386]

Special bad debt loss rules for small banks

Section 166 provides a deduction for any debt that becomes worthless (wholly or partially) within a taxable year. The reserve method of accounting for bad debts, repealed in 1986[387] for most taxpayers, is allowed under section 585 for any bank (as defined in section 581) other than a large bank. For this purpose, a bank is a large bank if, for the taxable year (or for any preceding taxable year after 1986), the average adjusted basis of all its assets (or the assets of the controlled group of which it is a member) exceeds $500 million. Deductions for reserves are taken in lieu of a worthless debt deduction under section 166. Accordingly, a small bank is able to take deductions for additions to a bad debt reserve. Additions to the reserve are determined under an experience method that generally looks to the ratio of (1) the total bad debts sustained during the taxable year and the five preceding taxable years to (2) the sum of the loans outstanding at the close of such taxable years.[388]

Credit unions

Credit unions are exempt from Federal income taxation.[389] The exemption is based on their status as not-for-profit mutual or cooperative organizations (without capital stock) operated for the benefit of their members, who generally must share a common bond. The definition of common bond has been expanded to permit greater use of credit unions.[390] While significant

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385 While the general principles for determining the taxable income of a corporation are applicable to a mutual savings bank, a building and loan association, and a cooperative bank, there are certain exceptions and special rules for such institutions. Treas. Reg. sec. 1.581-2(a).

386 Sec. 1361(b)(2)(A).

387 Tax Reform Act of 1986, Pub. L. No. 99-514.

388 Sec. 585(b)(2).

389 Sec. 501(c)(14)(A). For a discussion of the history of and reasons for Federal tax exemption, see United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions,* Report 3070, January 15, 2001, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

390 The Credit Union Membership Access Act, Pub. L. No. 105-219, allows multiple common bond credit unions. The legislation in part responds to *National Credit Union Administration v. First National Bank & Trust Co.*, 522 U.S. 479 (1998), which interpreted the permissible membership of tax-exempt credit unions narrowly.

differences between the rules under which credit unions and banks operate have existed in the past, most of those differences have disappeared over time.[391]

FDIC premiums

The Federal Deposit Insurance Corporation ("FDIC") provides deposit insurance for banks and savings institutions. To maintain its status as an insured depository institution, a bank must pay semiannual assessments into the deposit insurance fund. Assessments for deposit insurance are treated as ordinary and necessary business expenses. These assessments, also known as premiums, are deductible once the all events test for the premium is satisfied.[392]

Description of Proposal

No deduction is allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer. For taxpayers with total consolidated assets of $50 billion or more, the applicable percentage is 100 percent. Otherwise, the applicable percentage is the ratio of the excess of total consolidated assets over $10 billion to $40 billion. For example, for a taxpayer with total consolidated assets of $20 billion, no deduction is allowed for 25 percent of FDIC premiums. The proposal does not apply to taxpayers with total consolidated assets (as of the close of the taxable year) that do not exceed $10 billion.

FDIC premium means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act.[393] The term total consolidated assets has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[394]

For purposes of determining a taxpayer's total consolidated assets, members of an expanded affiliated group are treated as a single taxpayer. An expanded affiliated group means an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to the exceptions from the definition of includible corporation for insurance companies and foreign corporations. A partnership or any other entity other than a corporation is treated as a member of an expanded affiliated group if such entity is controlled by members of such group.

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[391] The Treasury Department has concluded that any remaining regulatory differences do not raise competitive equity concerns between credit unions and banks. United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions,* Report 3070, January 15, 2001, p. 2, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

[392] Technical Advice Memorandum 199924060, March 5, 1999, and Rev. Rul. 80-230, 1980-2 C.B. 169, 1980.

[393] 12 U.S.C. sec. 1817(b).

[394] Pub. L. No. 111-203.

Effective Date

The provision applies to taxable years beginning after December 31, 2017.

2. Repeal of advance refunding bonds

Present Law

Section 103 generally provides that gross income does not include interest received on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals).[395] Bonds issued to finance the activities of charitable organizations described in section 501(c)(3) ("qualified 501(c)(3) bonds") are one type of private activity bond. The exclusion from income for interest on State and local bonds only applies if certain Code requirements are met.

The exclusion for income for interest on State and local bonds applies to refunding bonds but there are limits on advance refunding bonds. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). Different rules apply to current as opposed to advance refunding bonds. A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. Conversely, a bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond.[396] Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed.

Although there is no statutory limitation on the number of times that tax-exempt bonds may be currently refunded, the Code limits advance refundings. Generally, governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time.[397] Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.[398] Furthermore, in the case of an advance refunding bond that results in interest savings (*e.g.*, a high interest rate to low interest rate refunding), the refunded bond must be redeemed on the first call date 90 days after the issuance of the refunding bond that results in debt service savings.[399]

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[395] Sec. 141.

[396] Sec. 149(d)(5).

[397] Sec. 149(d)(3). Bonds issued before 1986 and pursuant to certain transition rules contained in the Tax Reform Act of 1986 may be advance refunded more than one time in certain cases.

[398] Sec. 149(d)(2).

[399] Sec. 149(d)(3)(A)(iii) and (B); Treas. Reg. sec. 1.149(d)-1(f)(3). A "call" provision provides the issuer of a bond with the right to redeem the bond prior to the stated maturity.

Description of Proposal

The proposal repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.

Effective Date

The proposal applies to advance refunding bonds issued after December 31, 2017.

3. Cost basis of specified securities determined without regard to identification

Present Law

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, as the result of sale of property). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized on the sale and the taxpayer's adjusted basis in the property disposed of.[400]

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.[401] The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital improvements with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares sold are deemed to be drawn from the earliest acquired shares (the "first-in-first-out rule").[402] However, if a taxpayer makes an adequate identification ("specific identification") of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.[403] A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification

[400] Sec. 1001.

[401] Sec. 1016.

[402] Treas. Reg. sec. 1.1012-1(c)(1).

[403] Treas. Reg. sec. 1.1012-1(c)(2).

or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations (together, the "average basis method").[404]

In the case of the sale, exchange, or other disposition of a specified security (defined below) to which the basis reporting requirement described below applies, the first-in-first-out rule, specific identification, and average basis method conventions are applied on an account by account basis.[405] To facilitate the determination of the cost of RIC stock under the average basis method, RIC stock acquired before January 1, 2012, generally is treated as a separate account from RIC stock acquired on or after that date unless the RIC (or a broker holding the stock as a nominee) elects otherwise with respect to one or more of its stockholders, in which case all the RIC stock with respect to which the election is made is treated as a single account and the basis reporting requirement described below applies to all that stock.[406]

The basis of stock acquired after December 31, 2010, in connection with a dividend reinvestment plan ("DRP") is determined under the average basis method for as long as the stock is held as part of that plan.[407]

Basis reporting

A broker is required to report to the IRS a customer's adjusted basis in a covered security that the customer has sold and whether any gain or loss from the sale is long-term or short-term.[408]

A covered security is, in general, any specified security acquired after an applicable date specified in the basis reporting rules. A specified security is any share of stock of a corporation (including stock of a RIC); any note, bond, debenture, or other evidence of indebtedness; any commodity, or contract or derivative with respect to such commodity, if the Treasury Secretary determines that adjusted basis reporting is appropriate; and any other financial instrument with respect to which the Treasury Secretary determines that adjusted basis reporting is appropriate.

For purposes of satisfying the basis reporting requirements, a broker must determine a customer's adjusted basis in accordance with rules intended to ensure that the broker's reported adjusted basis numbers are the same numbers that customers must use in filing their tax returns.[409]

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[404] Treas. Reg. sec. 1.1012-1(e).

[405] Sec. 1012(c)(1).

[406] Sec. 1012(c)(2).

[407] Sec. 1012(d)(1). Other special rules apply to DRP stock. See sec. 1012(d)(2) and (3).

[408] Sec. 6045(g); Treas. Reg. sec. 1.6045-1(d).

[409] See sec. 6045(g)(2).

Description of Proposal

The proposal requires that the cost of any specified security sold, exchanged, or otherwise disposed of on or after January 1, 2018, be determined on a first-in first-out basis except to the extent the average basis method is otherwise allowed (as in the case of stock of a RIC).

The proposal includes several conforming amendments, including a rule restricting a broker's basis reporting method to the first-in first-out method in the case of the sale of any stock for which the average basis method is not permitted.

Effective Date

The proposal applies to sales, exchanges, and other dispositions after December 31, 2017.

H. Compensation

1. Nonqualified deferred compensation

Present Law

In general

Compensation may be received currently or may be deferred to a later time. The tax treatment of deferred compensation depends on whether it is qualified (that is, eligible for tax-favored treatment)[410] or nonqualified and, if nonqualified, whether it is funded or unfunded. In the case of a funded nonqualified deferred compensation arrangement, funded amounts are included in income when the right to the compensation vests, that is, when it is no longer subject to a substantial risk of forfeiture.[411] Earnings after vesting may be taxed annually or when paid.

Under general tax principles, unfunded nonqualified deferred compensation generally is not included in income until actually or constructively received.[412] However, under statutory rules generally applicable to nonqualified deferred compensation arrangements, income inclusion is delayed until receipt only if specific requirements are met. Otherwise, deferred amounts are included in income at vesting, with certain additional income taxes. In addition, in the case of certain arrangements, statutory rules require nonqualified deferred compensation to be included in income at vesting, and depending on the arrangement, earnings after vesting may be taxed annually or when paid.

General rules for nonqualified deferred compensation

In general

Various requirements apply to a nonqualified deferred compensation plan in order to avoid income inclusion at vesting.[413] Absent a specific exception, these requirements apply in addition to any special rules for particular types of nonqualified deferred compensation plans.

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[410] For a discussion of present law relating to tax-favored retirement plans, see Joint Committee on Taxation, *Report to the House Committee on Ways and Means on Present Law and Suggestions for Reform Submitted to the Tax Reform Working Groups* (JCS-3-13), May 6, 2013, Part II.I.

[411] Depending on the funding vehicle, the tax treatment of funded nonqualified deferred compensation may be governed by section 83, 402(b), or 403(c). Similar treatment applies under a common law doctrine of economic benefit, as applied, for example, in *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952), and Rev. Rul. 60-31, Situation 4, 1960-1 C.B. 174. Under section 404(a)(5), (b), and (d), nonqualified deferred compensation is generally deductible by the service recipient for the taxable year in which the amount is includible in the service provider's income, subject to any applicable limits on deductibility.

[412] Treas. Reg. secs. 1.451-1(a) and 1.451-2; Rev. Rul. 60-31, 1960-1 C.B. 174.

[413] Section 409A, generally effective for amounts deferred in taxable years beginning after December 31, 2004. For further discussion of the tax treatment of nonqualified deferred compensation before 2005 and concerns

A nonqualified deferred compensation plan must provide that compensation for services performed during a taxable year generally may be deferred at the service provider's election only if the election to defer is made no later than the close of the preceding taxable year (or at such other time as provided in Treasury regulations). In the case of any performance-based compensation for services performed over a period of at least 12 months, the election may be made no later than six months before the end of the service period. The time and form of distributions from the plan must be specified at the time of initial deferral. However, subject to certain requirements, a plan may allow later changes in the time and form of distributions.

Distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary of the Treasury), death, a specified time (or pursuant to a fixed schedule), change in control of a corporation (to the extent provided by the Secretary of the Treasury), occurrence of an unforeseeable emergency, or if the service provider becomes disabled.[414] A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary of the Treasury, may not permit acceleration of a distribution.

If these requirements are not met, all amounts deferred by a service provider under the plan are currently includible in income to the extent such amounts are not subject to a substantial risk of forfeiture and not previously included in gross income.[415] For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any person or the occurrence of a condition related to a purpose of the compensation, provided that the possibility of forfeiture is substantial. A condition imposed on the right to compensation may constitute a substantial risk of forfeiture

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that led to the enactment of section 409A, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS-5-05), May 2005.

[414] Under a special rule, when a "specified employee" separates from service, distributions may not be made earlier than six months after the date of the separation from service or, if earlier, the date of the employee's death. Specified employees are key employees (as defined in section 416(i)) of publicly-traded corporations and generally include officers (limited to 50 employees) having annual compensation greater than \$175,000 (for 2017), five-percent owners, and one-percent owners having annual compensation from the employer greater than \$150,000.

[415] In the case of an employee, under section 3401(a), the amount included in income constitutes wages subject to income tax withholding. In addition to current income inclusion, an interest factor tax at the rate applicable to underpayments of tax plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or, if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax. Under section 409A(b), current income inclusion, interest, and a 20-percent additional tax may also result from certain arrangements involving offshore assets set aside to fund nonqualified deferred compensation (regardless of whether the assets are available to satisfy claims of the general creditors of the service recipient), the restriction of assets to provide nonqualified deferred compensation in connection with a change in the employer's financial health, or assets set aside to provide nonqualified deferred compensation during a period when the employer (or controlled group member) maintains an underfunded defined benefit plan.

even if the imposition of the condition was intended in whole or in part to defer taxation of the compensation to the service provider.[416]

Definition of nonqualified deferred compensation plan

A nonqualified deferred compensation plan subject to these rules generally includes any plan, agreement or arrangement (including an agreement or arrangement that includes one person) that provides for the deferral of compensation (including actual or notional income on deferred compensation), other than a qualified employer plan, or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.[417] A qualified employer plan for this purpose means a qualified retirement plan, a tax-deferred annuity plan, a simplified employee pension plan, a simple retirement account plan, an eligible deferred compensation plan of a tax-exempt or State or local government employer, a plan established before June 25, 1959, and funded only by employee contributions, or a qualified governmental excess benefit arrangement.[418]

Under Treasury regulations, certain other types of arrangements are not considered a deferral of compensation and thus are not subject to these rules.[419] For example, an exception applies to amounts that are not deferred beyond a short period of time after the amount is no longer subject to a substantial risk of forfeiture (referred to as a "short-term deferral").[420] Under this exception, a deferral of compensation generally does not occur if the service provider actually or constructively receives the amount on or before the last day of the applicable two and one-half month period. The applicable two and one-half month period is the period ending on the later of the 15th day of the third month following the end of: (1) the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture; or (2) the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture.

In addition, Treasury regulations provide an exception for certain separation pay (severance) arrangements. This exception applies to separation pay pursuant to a window program, or separation pay provided upon an involuntary separation from service (as defined) that meets certain requirements as to amount and timing of payment. The amount cannot exceed twice the service provider's annualized compensation in the preceding taxable year (or if less, twice the section 401(a)(17) limit in effect for the year in which the separation from service occurs); and the plan must require this amount to be paid no later than the end of the second

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[416] Sec. 409A(d)(4) and Treas. Reg. sec. 1.409A-1(d). The Secretary of the Treasury is authorized to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 409A.

[417] Sec. 409A(d)(1).

[418] Secs. 401(a), 403(a) and (b), 408(k) and (p), 457(b), 501(c)(18), and 415(m).

[419] For a discussion of intended exceptions for certain arrangements, see Conference Report to accompany H.R. 4520, the American Jobs Creation Act of 2004, H.R. Rep. No. 108-755, October 7, 2004, p. 735.

[420] Treas. Reg. sec. 1.409A-1(b)(4).

taxable year following the end of the service provider's taxable year in which the separation from service occurred.[421]

Treasury regulations also provide exceptions for certain stock options and stock appreciation rights ("SARs") with respect to service recipient stock, referred to collectively as "stock rights."[422] In general, under the regulations, a stock option or SAR does not provide for the deferral of compensation if the exercise price of the stock option or SAR cannot be less than the fair market value, on the date the option or SAR is granted, of the stock subject to the option or SAR and the stock right does not otherwise include a deferral feature. Similar exceptions apply to arrangements involving mutual company units and partnership interests. Exceptions apply also for incentive stock options and options under an employee stock purchase plan ("statutory options").[423]

Additional rules

Under Treasury regulations, the term "service provider" includes an individual or any of specified entities for any taxable year for which the individual or entity accounts for income from the performance of services under the cash receipts and disbursements method of accounting.[424] The relevant entities are a corporation, an S corporation, a partnership, a personal service corporation, a noncorporate entity that would be a personal service corporation if it were a corporation, a qualified personal service corporation, and a noncorporate entity that would be a qualified personal service corporation if it were a corporation. However, an exception applies for a service provider engaged in the trade or business of providing services (other than as an employee or director of a corporation or in a similar position in the case of an entity that is not a corporation) if the service provider provides significant services to at least two service recipients that are not related to each other or the service provider. This exception does not apply to the extent the service provider provides management services, that is, services involving the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient, or investment management or advisory services provided to a service recipient whose primary trade or business includes the investment of financial assets (including real estate investments), such as a hedge fund or real estate investment trust.

[421] Treas. Reg. sec. 1.409A-1(b)(9)(iii).

[422] Treas. Reg. sec. 1.409A-1(b)(5). A SAR is a right to compensation based on the appreciation in value of a specified number of shares of stock occurring between the date of grant and the date of exercise of the right. In the case of a SAR, the exercise price is the amount subtracted from the fair market value of the stock on the date the SAR is exercised to determine the appreciation in value since the date of grant.

[423] Secs. 421-424.

[424] Treas. Reg. sec. 1.409A-1(f).

Nonqualified deferred compensation of State or local government or tax-exempt employers

Special rules apply to "eligible[425]" and "ineligible" deferred compensation plans of State and local government and tax-exempt employers.[426]

Amounts deferred under an eligible deferred compensation plan generally are not included in income until received. In order for a plan to be an eligible plan, the plan must limit deferrals to a dollar amount ($18,000 for 2017, plus an additional "catch-up" amount for older participants) or, if less, the participant's includible compensation. The plan must also meet various other requirements.

In the case of an ineligible deferred compensation plan (that is, a plan that does not meet the requirements to be an eligible plan), deferred amounts are treated as nonqualified deferred compensation and includible in income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, even though the plan is unfunded. For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any individual.[427] Earnings post vesting are generally taxed when paid.

Certain plans are excluded from being treated as deferred compensation, including bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefits.[428]

Nonqualified deferred compensation from certain tax indifferent parties

In general

Under special rules, any compensation deferred under a nonqualified deferred compensation plan of a nonqualified entity is generally includible in income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation, regardless of the method of accounting used by the service provider.[429] For this purpose, a service provider's rights to compensation are subject to a substantial risk of forfeiture

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[425] Some aspects of the rules for eligible deferred compensation plans are quite different for plans of State or local government employers and plans of tax-exempt employers. In particular, an eligible deferred compensation plan of a State or local government is a tax-favored, funded arrangement, similar to a qualified defined contribution plan, whereas an eligible deferred compensation plan of a tax-exempt employer must be unfunded. These rules in effect limit the amount of unfunded nonqualified deferred compensation that can be provided on a tax-deferred basis by a tax-exempt employer.

[426] Sec. 457, which also contains exceptions for various arrangements.

[427] Sec. 457(f)(3)(B).

[428] Sec. 457(e)(11)(A).

[429] Section 457A, generally effective for deferred amounts attributable to services performed after December 31, 2008.

only if the rights are conditioned on the future performance of substantial services by any individual.[430] A condition related to a purpose of the compensation (other than future performance of substantial services) does not result in a substantial risk of forfeiture.

If the amount of any deferred compensation is not determinable at the time the compensation is otherwise includible in income, the compensation is includible when the amount becomes determinable. In that case, the income tax attributable to the compensation includible in income is increased by the sum of (1) an interest charge, and (2) an amount equal to 20 percent of the includible compensation. The interest charge is equal to the interest at the rate applicable to underpayments of tax plus one percentage point imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

Nonqualified entity

The term "nonqualified entity" includes certain foreign corporations and certain partnerships (either domestic or foreign). A foreign corporation is a nonqualified entity unless substantially all of its income is effectively connected with the conduct of a U.S. trade or business or is subject to a comprehensive foreign income tax. A partnership is a nonqualified entity unless substantially all of its income is allocated to persons other than foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax and organizations exempt from U.S. income tax.

The term comprehensive foreign income tax means with respect to a foreign person, the income tax of a foreign country if (1) the person is eligible for the benefits of a comprehensive income tax treaty between the foreign country and the United States, or (2) the person demonstrates to the satisfaction of the Secretary of the Treasury that the foreign country has a comprehensive income tax.

Nonqualified deferred compensation

For purposes of these special rules, the term "nonqualified deferred compensation plan" is generally defined in the same manner as under the general rules for nonqualified deferred compensation (and includes any agreement or arrangement, as well as actual or notional income on deferred compensation) with certain modifications.

Nonqualified deferred compensation includes any plan that provides a right to compensation based on the appreciation in value of a specified number of equity units of the

[430] Under section 457A(d)(1)(B), to the extent provided in regulations, if compensation is determined solely by reference to the amount of gain recognized on the disposition of an investment asset, the compensation is treated as subject to a substantial risk of forfeiture until the date of such disposition. No regulations or other guidance applying this rule has been issued.

service recipient.[431] However, IRS guidance provides some exceptions.[432] In general, under the guidance, a stock option is not treated as nonqualified deferred compensation for this purpose if the exercise price of the stock option cannot be less than the fair market value, on the date the option is granted, of the stock subject to the option and the option does not otherwise include a deferral feature. A similar exception applies to arrangements involving the right to purchase an equity interest in a noncorporate entity. Exceptions apply also for statutory options. Finally, an exception applies for a SAR if the exercise price of the SAR cannot be less than the fair market value, on the date the SAR is granted, of the stock subject to the SAR and the SAR does not otherwise include a deferral feature, but only if the SAR by its terms at all times must be settled in service recipient stock and is settled in service recipient stock.

A special "short-term deferral" exception applies, under which compensation is not treated as deferred if the service provider receives payment of the compensation not later than 12 months after the end of the taxable year of the service recipient during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture (within the meaning of the special rules).

Description of Proposal

In general

Under the proposal, any compensation deferred under a nonqualified deferred compensation plan is includible in the gross income of the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation. For this purpose, the rights of a service provider to compensation are treated as subject to a substantial risk of forfeiture only if the rights are conditioned on the future performance of substantial services by any individual. Under the proposal, a condition related to a purpose of the compensation other than the future performance of substantial services (such as a condition based on achieving a specified performance goal or a condition intended in whole or in part to defer taxation) does not create a substantial risk of forfeiture, regardless of whether the possibility of forfeiture is substantial. In addition, a covenant not to compete does not create a substantial risk of forfeiture.

The proposal applies without regard to the method of accounting of the service provider. Because of the definition of substantial risk of forfeiture under the proposal, a taxpayer using either the cash method of accounting or the accrual method of accounting may be required to include deferred compensation in income earlier than the method of accounting would otherwise require.

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[431] Sec. 457A(d)(3)(A). The Secretary of the Treasury is authorized to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 457A.

[432] Notice 2009-8, 2009-1 C.B. 347, A-2(b). For a discussion of intended exceptions for certain arrangements, see Committee on Ways and Means Report to accompany H.R. 6049, the Renewable Energy and Job Creation Act of 2008, H.R. Rep. No. 110-658, May 20, 2008, pp. 195-196.

Nothing under the proposal is to be construed to prevent the inclusion of amounts in income under any other income tax provision or any other rule of law earlier than the time provided in the proposal. Any amount included in income under the proposal is not required to be included in income under any other income tax provision or any other rule of law later than the time provided under the proposal.

Nonqualified deferred compensation

For purposes of the proposal, the term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than a qualified employer plan, a bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plan, and any other plan or arrangement designated by the Secretary of the Treasury consistent with the purposes of the proposal. The Secretary shall not provide an exception for severance plans, bona fide or otherwise, in regulations or other guidance. A qualified employer plan for this purpose means a qualified retirement plan, a tax-deferred annuity plan, a simplified employee pension plan, a simple retirement account plan, an eligible deferred compensation plan of a State or local government employer, or a plan established before June 25, 1959, and funded only by employee contributions.

In addition, a nonqualified deferred compensation plan for purposes of the proposal specifically includes any plan that provides a right to compensation based on the value of, or the appreciation in value of, a specified number of equity units of the service recipient. Such a compensation right does not fail to provide for the deferral of compensation merely because the compensation is to be paid in cash or by the transfer of equity. The proposal applies to all stock options and SARs (and similar arrangements involving noncorporate entities), regardless of how the exercise price compares to the value of the related stock on the date the option or SAR is granted. It is intended that no exceptions are to be provided in regulations or other administrative guidance. However, it is intended that statutory options are not considered nonqualified deferred compensation for purposes of the proposal. An exception is provided for that portion of a plan consisting of a transfer of property described in section 83 (other than nonstatutory stock options), or a trust to which section 402(b) applies, or relating to statutory options under section 422 or 423 for which there is no disqualifying disposition.

For purposes of the proposal, a plan includes any agreement or arrangement, including an agreement or arrangement that includes one person. In addition, references to deferred compensation are treated as including references to income (whether actual or notional) attributable to deferred compensation or income. However, compensation is not treated as deferred for purposes of the proposal if the service provider receives payment of the compensation not later than two and one-half months after the end of the service recipient's or service provider's taxable year, whichever is later, during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture (within the meaning of the proposal).

Additional rules

The Secretary of Treasury is directed to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal, including regulations disregarding a

substantial risk of forfeiture in cases where necessary to carry out the purposes of the proposal. Except as provided by the Secretary of the Treasury, for purposes of the proposal, rules similar to the controlled group rules for qualified retirement plans apply.[433]

Under the proposal, the present-law general rules for nonqualified deferred compensation and the present-law rules for nonqualified deferred compensation from certain tax indifferent parties are repealed. In addition, the present-law rules for eligible and ineligible deferred compensation plans of tax-exempt employers and for ineligible deferred compensation plans of State and local governments do not apply with respect to deferred amounts attributable to services performed after December 31, 2017.

In addition, the proposal applies income tax reporting and withholding, as applicable, to amounts required to be included in gross income of employees and other service providers, including nonresident aliens subject to U.S. taxation.

Effective Date

The proposal generally applies to amounts attributable to services performed after December 31, 2017. In the case of any deferred compensation amount to which the proposal does not otherwise apply solely by reason of the fact that the amount is attributable to services performed before January 1, 2018, to the extent such amount is not includible in gross income in a taxable year beginning before 2027, such amount is includible in income in the later of (1) the last taxable year before 2027, or (2) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation (determined in the same manner as determined under the proposal). Earnings on deferred amounts attributable to services performed before January 1, 2018, are subject to the proposal only to the extent that the amounts to which the earnings are attributable are subject to the proposal.

The Secretary of the Treasury is directed to issue guidance, no later than 120 days after enactment of the proposal, providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2017, may, without violating the general rules for nonqualified deferred compensation, be amended to conform the date of distribution to the service provider to the date amounts are required to be included in income under the proposal. If the service provider-taxpayer is also a service recipient and maintains one or more nonqualified deferred compensation arrangements for its service providers under which any amount is attributable to services performed on or before December 31, 2017, the guidance is to permit any such arrangement to be amended to conform the dates of distribution under that arrangement to the date amounts are required to be included in the income of the taxpayer. An amendment to a nonqualified deferred compensation arrangement made pursuant to the guidance is not to be treated as a material modification of the arrangement for purposes of the general rules for nonqualified deferred compensation.

[433] Sec. 414(b) and (c).

2. Modification of limitation on excessive employee remuneration

Present Law

In general

An employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) provides an explicit limitation on the deductibility of compensation expenses in the case of publicly traded corporate employers. The otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation[434] is limited to no more than $1 million per year.[435] The deduction limitation applies when the deduction would otherwise be taken.

Covered employees

Section 162(m) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year and (2) the four most highly compensated officers[436] for the taxable year (other than the chief executive officer). Treasury regulations under section 162(m) provide that whether an employee is the chief executive officer or among the four most highly compensated officers should be determined pursuant to the executive compensation disclosure rules promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

In 2006, the Securities and Exchange Commission amended certain rules relating to executive compensation, including which officers' compensation must be disclosed under the Exchange Act. Under the new rules, such officers are (1) the principal executive officer (or an individual acting in such capacity), (2) the principal financial officer (or an individual acting in such capacity), and (3) the three most highly compensated officers,[437] other than the principal executive officer or principal financial officer.

In response to the Securities and Exchange Commission's new disclosure rules, the Internal Revenue Service issued updated guidance on identifying which employees are covered by section 162(m).[438] The new guidance provides that "covered employee" means any employee who is (1) the principal executive officer (or an individual acting in such capacity) defined in

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[434] A corporation is treated as publicly held if it has a class of common equity securities that is required to be registered under section 12 of the Securities Exchange Act of 1934.

[435] Sec. 162(m). This deduction limitation applies for purposes of the regular income tax and the alternative minimum tax.

[436] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[437] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[438] Notice 2007-49, 2007-25 I.R.B. 1429.

reference to the Exchange Act, or (2) among the three most highly compensated officers[439] for the taxable year (other than the principal executive officer), again defined by reference to the Exchange Act. Thus, under current guidance, only four employees are covered under section 162(m) for any taxable year. Under Treasury regulations, the requirement that the individual meet the criteria as of the last day of the taxable year applies to both the principal executive officer and the three highest compensated officers.[440]

Definition of publicly held corporation

For purposes of the deduction disallowance of section 162(m), a publicly held corporation means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934. All U.S. publicly traded companies are subject to this registration requirement, including their foreign affiliates (to the extent subject to U.S. tax). A foreign company publicly traded through American depository receipts ("ADRs") is also subject to this registration requirement if more than 50 percent of the issuer's outstanding voting securities are held, directly or indirectly, by residents of United States and either (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States. Other foreign companies are not subject to the registration requirement.

Remuneration subject to the deduction limitation

In general

Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million cap is reduced by excess parachute payments (as defined in section 280G) that are not deductible by the corporation.

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million. The following types of compensation are not taken into account: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation"); (3) payments to a tax-favored retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross

[439] Such officers must also be employees whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[440] Treas. Reg. sec. 1.162-27(c)(2).

income (such as employer-provided health benefits and miscellaneous fringe benefits[441]); and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993. In addition, remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (*e.g.*, is not performance-based compensation) because the payment of compensation is deferred until after termination of employment.

Performance-based compensation

Compensation qualifies for the exception for performance-based compensation only if (1) it is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee consisting solely of two or more outside directors,[442] (3) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to and approved by the shareholders in a separate majority-approved vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

Compensation (other than stock options or other stock appreciation rights ("SARs")) is not treated as paid solely on account of the attainment of one or more performance goals unless the compensation is paid to the particular executive pursuant to a pre-established objective performance formula or standard that precludes discretion. A stock option or SAR with an exercise price not less than the fair market value, on the date the option or SAR is granted, of the stock subject to the option or SAR, generally is treated as meeting the exception for performance-based compensation, provided that the requirements for outside director and shareholder approval are met (without the need for certification that the performance standards have been met). This is the case because the amount of compensation attributable to the options or SARs received by the executive would be based solely on an increase in the corporation's stock price. Stock-based compensation is not treated as performance-based if it depends on factors other than corporate performance.

Description of Proposal

Definition of covered employee

The proposal revises the definition of covered employee to include both the principal executive officer and the principal financial officer. Further, an individual is a covered employee if the individual holds one of these positions at any time during the taxable year. The proposal also defines as a covered employee the three (rather than four) most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer) who

441 Secs. 105, 106, and 132.

442 A director is considered an outside director if he or she is not a current employee of the corporation (or related entities), is not a former employee of the corporation (or related entities) who is receiving compensation for prior services (other than benefits under a qualified retirement plan), was not an officer of the corporation (or related entities) at any time, and is not currently receiving compensation for personal services in any capacity (*e.g.*, for services as a consultant) other than as a director.

are required to be reported on the company's proxy statement for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders).

In addition, if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years. Thus, an individual remains a covered employee with respect to compensation otherwise deductible in subsequent years, including years during which the individual is no longer employed by the corporation (including years after the individual has died). Compensation does not fail to be compensation with respect to a covered employee and thus subject to the deduction limit for a taxable year merely because the compensation is includible in the income of, or paid to, another individual, such as compensation paid to a beneficiary after the employee's death, or to a former spouse pursuant to a domestic relations order.

Definition of publicly held corporation

The proposal extends the applicability of section 162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. The proposed definition may include certain additional corporations that are not publicly traded, such as large private C or S corporations.

Performance-based compensation and commissions exceptions

The proposal eliminates the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit. Thus, such compensation is taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million and is thus not deductible under section 162.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Excise tax on excess tax-exempt organization executive compensation

Present Law

Taxable employers and other service recipients are generally allowed a deduction for reasonable compensation expenses.[443] However, in some cases, compensation in excess of specific levels is not deductible.

In the case of a publicly held corporation, subject to certain exceptions, the deduction for a taxable year for compensation of the corporation's principal executive officer or for any of the

[443] Sec. 162(a)(1).

corporation's three most highly compensated officers other than the principal executive officer is limited to $1 million ("$1 million limit on deductible compensation").[444]

A "parachute payment" (generally a payment of compensation that is contingent on a change in corporate ownership or control) made to an officer, shareholder or highly compensated individual is generally not deductible if the aggregate present value of all such payments to an individual equals or exceeds three times the individual's base amount (an "excess parachute payment").[445] An individual's base amount is the average annual compensation includible in the individual's gross income for the five taxable years ending before the date the change in ownership or control occurs. Certain amounts are not considered parachute payments, including payments under a qualified retirement plan, a simplified employee pension plan, or a simple retirement account.[446]

These deduction limits generally do not affect a tax-exempt organization.

Description of Proposal

Under the proposal, an employer is liable for an excise tax equal to 20 percent of the sum of the (1) remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment (under a new definition for this purpose that relates solely to separation pay) paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million.

For purposes of the proposal, a covered employee is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016. An "applicable tax-exempt organization" is an organization exempt from tax under section 501(a), an exempt farmers' cooperative,[447] a Federal, State or local governmental entity with excludable income,[448] or a political organization.[449]

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[444] Sec. 162(m)(1). Under section 162(m)(6), limits apply to deductions for compensation of individuals performing services for certain health insurance providers.

[445] Sec. 280G.

[446] Secs. 401(a), 403(a), 408(k), and 408(p).

[447] Sec. 521(b).

[448] Sec. 115(1).

[449] Sec. 527(e)(1).

Remuneration means wages as defined for income tax withholding purposes,[450] but does not include any designated Roth contribution.[451] Remuneration of a covered employee includes any remuneration paid with respect to employment of the covered employee by any person or governmental entity related to the applicable tax-exempt organization. A person or governmental entity is treated as related to an applicable tax-exempt organization if the person or governmental entity (1) controls, or is controlled by, the organization, (2) is controlled by one or more persons that control the organization, (3) is a supported organization[452] during the taxable year with respect to the organization, (4) is a supporting organization[453] during the taxable year with respect to the organization, or (5) in the case of a voluntary employees' beneficiary association ("VEBA"),[454] establishes, maintains, or makes contributions to the VEBA. However, remuneration of a covered employee that is not deductible by reason of the $1 million limit on deductible compensation is not taken into account for purposes of the proposal.

Under the proposal, an excess parachute payment is the amount by which any parachute payment exceeds the portion of the base amount allocated to the payment. A parachute payment is a payment in the nature of compensation to (or for the benefit of a covered employee) if the payment is contingent on the employee's separation from employment and the aggregate present value of all such payments is three times or more the base amount. The base amount is the average annual compensation includible in the covered employee's gross income for the five taxable years ending before the date of the employee's separation from employment. Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity,[455] or an eligible deferred compensation plan of a State or local government employer.[456]

The employer of a covered employee is liable for the excise tax. If remuneration of a covered employee from more than one employer is taken into account in determining the excise tax, each employer is liable for the tax in an amount that bears the same ratio to the total tax as the remuneration paid by that employer bears to the remuneration paid by all employers to the covered employee.

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[450] Sec. 3401(a).

[451] Under section 402A(c), a designated Roth contribution is an elective deferral (that is, a contribution to a tax-favored employer-sponsored retirement plan made at the election of an employee) that the employee designates as not being excludable from income.

[452] Sec. 509(f)(3).

[453] Sec. 509(a)(3).

[454] Sec. 501(c)(9).

[455] Sec. 403(b).

[456] Sec. 457(b).

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

I. Insurance

1. Net operating losses of life insurance companies

Present Law

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[457]

For purposes of computing the alternative minimum tax ("AMT"), a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.[458]

In the case of a life insurance company, a deduction is allowed in the taxable year for operations loss carryovers and carrybacks, in lieu of the deduction for net operation losses allowed to other corporations.[459] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[460]

Description of Proposal

The proposal repeals the operations loss deduction for life insurance companies and allows the NOL deduction under section 172. This provides the same treatment for losses of life insurance companies as for losses of property and casualty insurance companies and of other corporations. The proposal thus limits the companies' NOL deduction to 90 percent of taxable income (determined without regard to the deduction), provides that carryovers to other years are adjusted to take account of this limitation and may be carried forward indefinitely. The NOL deduction of a life insurance company is determined by treating the NOL for any taxable year generally as the excess of the life insurance deductions for such taxable year over the life insurance gross income for such taxable year.

Effective Date

The proposal applies to losses arising in taxable years beginning after December 31, 2017.

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[457] Sec. 172(b)(2).

[458] Sec. 56(d).

[459] Secs. 810, 805(a)(5).

[460] Sec. 810(b)(1).

2. Repeal of small life insurance company deduction

Present Law

The small life insurance company deduction for any taxable year is 60 percent of so much of the tentative life insurance company taxable income ("LICTI") for such taxable year as does not exceed $3 million, reduced by 15 percent of the excess of tentative LICTI over $3 million. The maximum deduction that can be claimed by a small company is $1.8 million, and a company with a tentative LICTI of $15 million or more is not entitled to any small company deduction. A small life insurance company for this purpose is one with less than $500 million of assets.

Description of Proposal

The proposal repeals the small life insurance company deduction.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Adjustment for change in computing reserves

Present Law

Change in method of accounting

In general, a taxpayer may change its method of accounting under section 446 with the consent of the Secretary (or may be required to change its method of accounting by the Secretary). In such instances, a taxpayer generally is required to make an adjustment (a "section 481(a) adjustment") to prevent amounts from being duplicated in, or omitted from, the calculation of the taxpayer's income. Pursuant to IRS procedures, negative section 481(a) adjustments generally are deducted from income in the year of the change whereas positive section 481(a) adjustments generally are required to be included in income ratably over four taxable years.[461]

However, section 807(f) explicitly provides that changes in the basis for determining life insurance company reserves are to be taken into account ratably over 10 years.

10-year spread for change in computing life insurance company reserves

For Federal income tax purposes, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[462] Methods for determining

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[461] See, *e.g.*, Rev. Proc. 2015-13, 2015-5 I.R.B. 419, and Rev. Proc. 2017-30, 2017-18 I.R.B. 1131.

[462] Sec. 807.

reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

Income or loss resulting from a change in the method of computing reserves is taken into account ratably over a 10-year period.[463] The rule for a change in basis in computing reserves applies only if there is a change in basis in computing the Federally prescribed reserve (as distinguished from the net surrender value). Although life insurance tax reserves require the use of a Federally prescribed method, interest rate, and mortality or morbidity table, changes in other assumptions for computing statutory reserves (*e.g.*, when premiums are collected and claims are paid) may cause increases or decreases in a company's life insurance reserves that must be spread over a 10-year period. Changes in the net surrender value of a contract are not subject to the 10-year spread because, apart from its use as a minimum in determining the amount of life insurance tax reserves, the net surrender value is not a reserve but a current liability.

If for any taxable year the taxpayer is not a life insurance company, the balance of any adjustments to reserves is taken into account for the preceding taxable year.

Description of Proposal

Income or loss resulting from a change in method of computing life insurance company reserves is taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

4. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account

Present and Prior Law

Under the law in effect from 1959 through 1983, a life insurance company was subject to a three-phase taxable income computation under Federal tax law. Under the three-phase system, a company was taxed on the lesser of its gain from operations or its taxable investment income (Phase I) and, if its gain from operations exceeded its taxable investment income, 50 percent of such excess (Phase II). Federal income tax on the other 50 percent of the gain from operations was deferred, and was accounted for as part of a policyholder's surplus account and, subject to certain limitations, taxed only when distributed to stockholders or upon corporate dissolution (Phase III). To determine whether amounts had been distributed, a company maintained a shareholders surplus account, which generally included the company's previously taxed income that would be available for distribution to shareholders. Distributions to shareholders were

[463] Sec. 807(f).

treated as being first out of the shareholders surplus account, then out of the policyholders surplus account, and finally out of other accounts.

The Deficit Reduction Act of 1984[464] included provisions that, for 1984 and later years, eliminated further deferral of tax on amounts (described above) that previously would have been deferred under the three-phase system. Although for taxable years after 1983, life insurance companies may not enlarge their policyholders surplus account, the companies are not taxed on previously deferred amounts unless the amounts are treated as distributed to shareholders or subtracted from the policyholders surplus account.[465]

Any direct or indirect distribution to shareholders from an existing policyholders surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Present law (like prior law) provides that any distribution to shareholders is treated as made (1) first out of the shareholders surplus account, to the extent thereof, (2) then out of the policyholders surplus account, to the extent thereof, and (3) finally, out of other accounts.

For taxable years beginning after December 31, 2004, and before January 1, 2007, the application of the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a life insurance company were suspended. Distributions in those years were treated as first made out of the policyholders surplus account, to the extent thereof, and then out of the shareholders surplus account, and lastly out of other accounts.

Description of Proposal

The proposal repeals section 815, the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a stock life insurance company.

In the case of any stock life insurance company with an existing policyholders surplus account (as defined in section 815 before its repeal), tax is imposed on the balance of the account as of December 31, 2017. A life insurance company is required to pay tax on the balance of the account ratably over the first eight taxable years beginning after December 31, 2017. Specifically, the tax imposed on a life insurance company is the tax on the sum of life insurance company taxable income for the taxable year (but not less than zero) plus 1/8 of the balance of the existing policyholders surplus account as of December 31, 2017. Thus, life insurance company losses are not allowed to offset the amount of the policyholders surplus account balance subject to tax.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

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[464] Pub. L. No. 98-369.

[465] Sec. 815.

5. Modification of proration rules for property and casualty insurance companies

Present Law

The taxable income of a property and casualty insurance company is determined as the sum of its gross income from underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions.

A proration rule applies to property and casualty insurance companies. In calculating the deductible amount of its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15 percent of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment, or annuity contracts the company owns.[466] This proration rule reflects the fact that reserves are generally funded in part from tax-exempt interest, from deductible dividends, and from other untaxed amounts.

Description of Proposal

The proposal replaces the 15-percent reduction under present law with a reduction equal to 5.25 percent divided by the top corporate tax rate. For 2018, the top corporate tax rate is 35 percent, and the percentage reduction is 15 percent. For 2019 and thereafter, the corporate tax rate is 20 percent, and the percentage reduction is 26.25 percent under the proration rule for property and casualty insurance companies. The proration percentage will be automatically adjusted in the future if the top corporate tax rate is changed, so that the product of the proration percentage and the top corporate tax rate always equals 5.25 percent.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

6. Repeal of special estimated tax payments

Present Law

Allowance of additional deduction and establishment of special loss discount account

Present law allows an insurance company required to discount its reserves an additional deduction that is not to exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year.[467] The provision imposes the requirement that a special loss discount account be established and maintained, and that special estimated tax payments be made. Unused amounts of special estimated tax payments are treated as a section 6655 estimated

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[466] Sec. 832(b)(5).

[467] Sec. 847.

tax payment for the 16th year after the year for which the special estimated tax payment was made.

The total payments by a taxpayer, including section 6655 estimated tax payments and other tax payments, together with special estimated tax payments made under this provision, are generally the same as the total tax payments that the taxpayer would make if the taxpayer did not elect to have this provision apply, except to the extent amounts can be refunded under the provision in the 16th year.

Calculation of special estimated tax payments based on tax benefit attributable to deduction

More specifically, present law imposes a requirement that the taxpayer make special estimated tax payments in an amount equal to the tax benefit attributable to the additional deduction allowed under the provision. If amounts are included in gross income as a result of a reduction in the taxpayer's special loss discount account or the liquidation or termination of the taxpayer's insurance business, and an additional tax is due for any year as a result of the inclusion, then an amount of the special estimated tax payments equal to such additional tax is applied against such additional tax. If there is an adjustment reducing the amount of additional tax against which the special estimated tax payment was applied, then in lieu of any credit or refund for the reduction, a special estimated tax payment is treated as made in an amount equal to the amount that would otherwise be allowable as a credit or refund.

The amount of the tax benefit attributable to the deduction is to be determined (under Treasury regulations (which have not been promulgated)) by taking into account tax benefits that would arise from the carryback of any net operating loss for the year as well as current year benefits. In addition, tax benefits for the current and carryback years are to take into account the benefit of filing a consolidated return with another insurance company without regard to the consolidation limitations imposed by section 1503(c).

The taxpayer's estimated tax payments under section 6655 are to be determined without regard to the additional deduction allowed under this provision and the special estimated tax payments. Legislative history[468] indicates that it is intended that the taxpayer may apply the amount of an overpayment of any section 6655 estimated tax payments for the taxable year against the amount of the special estimated tax payment required under this provision. The special estimated tax payments under this provision are not treated as estimated tax payments for purposes of section 6655 (*e.g.*, for purposes of calculating penalties or interest on underpayments of estimated tax) when such special estimated tax payments are made.

Refundable amount

To the extent that a special estimated tax payment is not used to offset additional tax due for any of the first 15 taxable years beginning after the year for which the payment was made, such special estimated tax payment is treated as an estimated tax payment made under

[468] See H.R. Rep. No. 100-1104, Conference Report to accompany H.R. 4333, the Technical and Miscellaneous Revenue Act of 1988, October 21, 1988, p. 174.

section 6655 for the 16th year after the year for which the special estimated tax payment was made. If the amount of such deemed section 6655 payment, together with the taxpayer's other payments credited against tax liability for such 16th year, exceeds the tax liability for such year, then the excess (up to the amount of the deemed section 6655 payment) may be refunded to the taxpayer to the same extent provided under present law with respect to overpayments of tax.

Regulatory authority

In addition to the regulatory authority to adjust the amount of special estimated tax payments in the event of a change in the corporate tax rate, authority is provided to Treasury to prescribe regulations necessary or appropriate to carry out the purposes of the provision.

Such regulations include those providing for the separate application of the provision with respect to each accident year. Separate application of the provision with respect to each accident year (*i.e.*, applying a vintaging methodology) may be appropriate under regulations to determine the amount of tax liability for any taxable year against which special estimated tax payments are applied, and to determine the amount (if any) of special estimated tax payments remaining after the 15th year which may be available to be refunded to the taxpayer.

Regulatory authority is also provided to make such adjustments in the application of the provision as may be necessary to take into account the corporate alternative minimum tax. Under this regulatory authority, rules similar to those applicable in the case of a change in the corporate tax rate are intended to apply to determine the amount of special estimated tax payments that may be applied against tax calculated at the corporate alternative minimum tax rate. The special estimated tax payments are not treated as payments of regular tax for purposes of determining the taxpayer's alternative minimum tax liability.

Regulations have not been promulgated under section 847.

Description of Proposal

The proposal repeals section 847. Thus, the election to apply section 847, the additional deduction, special loss discount account, special estimated tax payment, and refundable amount rules of present law are eliminated.

The entire balance of an existing account is included in income of the taxpayer for the first taxable year beginning after 2017, and the entire amount of existing special estimated tax payments are applied against the amount of additional tax attributable to this inclusion. Any special estimated tax payments in excess of this amount are treated as estimated tax payments under section 6655.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

7. Capitalization of certain policy acquisition expenses

Present Law

In the case of an insurance company, specified policy acquisition expenses for any taxable year are required to be capitalized, and generally are amortized over the 120-month period beginning with the first month in the second half of the taxable year.[469]

A special rule provides for 60-month amortization of the first $5 million of specified policy acquisition expenses with a phase-out. The phase-out reduces the amount amortized over 60 months by the excess of the insurance company's specified policy acquisition expenses for the taxable year over $10 million.

Specified policy acquisition expenses are determined as that portion of the insurance company's general deductions for the taxable year that does not exceed a specific percentage of the net premiums for the taxable year on each of three categories of insurance contracts. For annuity contracts, the percentage is 1.75; for group life insurance contracts, the percentage is 2.05; and for all other specified insurance contracts, the percentage is 7.7.

With certain exceptions, a specified insurance contract is any life insurance, annuity, or noncancellable accident and health insurance contract or combination thereof. A group life insurance contract is any life insurance contract that covers a group of individuals defined by reference to employment relationship, membership in an organization, or similar factor, the premiums for which are determined on a group basis, and the proceeds of which are payable to (or for the benefit of) persons other than the employer of the insured, an organization to which the insured belongs, or other similar person.

Description of Proposal

The proposal extends the amortization period for specified policy acquisition expenses from a 120-month period to the 600-month period beginning with the first month in the second half of the taxable year. The proposal does not change the special rule providing for 60-month amortization of the first $5 million of specified policy acquisition expenses (with phaseout). The proposal provides that for annuity contracts, the percentage is 3.17; for group life insurance contracts, the percentage is 3.72; and for all other specified insurance contracts, the percentage is 13.97.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

[469] Sec. 848.

8. Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules

Present Law

An exclusion from Federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured.[470]

Under rules known as the transfer for value rules, if a life insurance contract is sold or otherwise transferred for valuable consideration, the amount paid by reason of the death of the insured that is excludable generally is limited.[471] Under the limitation, the excludable amount may not exceed the sum of (1) the actual value of the consideration, and (2) the premiums or other amounts subsequently paid by the transferee of the contract. Thus, for example, if a person buys a life insurance contract, and the consideration he pays combined with his subsequent premium payments on the contract are less than the amount of the death benefit he later receives under the contract, then the difference is includable in the buyer's income.

Exceptions are provided to the limitation on the excludable amount. The limitation on the excludable amount does not apply if (1) the transferee's basis in the contract is determined in whole or in part by reference to the transferor's basis in the contract,[472] or (2) the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.[473]

IRS guidance sets forth more details of the tax treatment of a life insurance policyholder who sells or surrenders the life insurance contract and the tax treatment of other sellers and of

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[470] Sec. 101(a)(1). In the case of certain accelerated death benefits and viatical settlements, special rules treat certain amounts as amounts paid by reason of the death of an insured (that is, generally, excludable from income). Sec. 101(g). The rules relating to accelerated death benefits provide that amounts treated as paid by reason of the death of the insured include any amount received under a life insurance contract on the life of an insured who is a terminally ill individual, or who is a chronically ill individual (provided certain requirements are met). For this purpose, a terminally ill individual is one who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 24 months or less after the date of the certification. A chronically ill individual is one who has been certified by a licensed health care practitioner within the preceding 12-month period as meeting certain ability-related requirements. In the case of a viatical settlement, if any portion of the death benefit under a life insurance contract on the life of an insured who is terminally ill or chronically ill is sold to a viatical settlement provider, the amount paid for the sale or assignment of that portion is treated as an amount paid under the life insurance contract by reason of the death of the insured (that is, generally, excludable from income). For this purpose, a viatical settlement provider is a person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of terminally ill or chronically ill individuals (provided certain requirements are met).

[471] Sec. 101(a)(2).

[472] Sec. 101(a)(2)(A).

[473] Sec. 101(a)(2)(B).

buyers of life insurance contracts. The guidance relates to the character of taxable amounts (ordinary or capital) and to the taxpayer's basis in the life insurance contract.

In Revenue Ruling 2009-13,[474] the IRS ruled that income recognized under section 72(e) on surrender to the life insurance company of a life insurance contract with cash value is ordinary income. In the case of sale of a cash value life insurance contract, the IRS ruled that the insured's (seller's) basis is reduced by the cost of insurance, and the gain on sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered (the "inside buildup"), and any excess is long-term capital gain. Gain on the sale of a term life insurance contract (without cash surrender value) is long-term capital gain under the ruling.

In Revenue Ruling 2009-14,[475] the IRS ruled that under the transfer for value rules, a portion of the death benefit received by a buyer of a life insurance contract on the death of the insured is includable as ordinary income. The portion is the excess of the death benefit over the consideration and other amounts (*e.g.*, premiums) paid for the contract. Upon sale of the contract by the purchaser of the contract, the gain is long-term capital gain, and in determining the gain, the basis of the contract is not reduced by the cost of insurance.

Description of Proposal

In general

The provision imposes reporting requirements in the case of the purchase of an existing life insurance contract in a reportable policy sale and imposes reporting requirements on the payor in the case of the payment of reportable death benefits. The provision sets forth rules for determining the basis of a life insurance or annuity contract. Lastly, the provision modifies the transfer for value rules in a transfer of an interest in a life insurance contract in a reportable policy sale.

Reporting requirements for acquisitions of life insurance contracts

Reporting upon acquisition of life insurance contract

The reporting requirement applies to every person who acquires a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale during the taxable year. A reportable policy sale means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured (apart from the acquirer's interest in the life insurance contract). An indirect acquisition includes the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract.

Under the reporting requirement, the buyer reports information about the purchase to the IRS, to the insurance company that issued the contract, and to the seller. The information

[474] 2009-21 I.R.B. 1029.

[475] 2009-21 I.R.B. 1031.

reported by the buyer about the purchase is (1) the buyer's name, address, and taxpayer identification number ("TIN"), (2) the name, address, and TIN of each recipient of payment in the reportable policy sale, (3) the date of the sale, and (4) the amount of each payment. The statement the buyer provides to any issuer of a life insurance contract is not required to include the amount of the payment or payments for the purchase of the contract.

Reporting of seller's basis in the life insurance contract

On receipt of a report described above, or on any notice of the transfer of a life insurance contract to a foreign person, the issuer is required to report to the IRS and to the seller (1) the basis of the contract (i.e., the investment in the contract within the meaning of section 72(e)(6)), (2) the name, address, and TIN of the seller or the transferor to a foreign person, and (3) the policy number of the contract. Notice of the transfer of a life insurance contract to a foreign person is intended to include any sort of notice, including information provided for nontax purposes such as change of address notices for purposes of sending statements or for other purposes, or information relating to loans, premiums, or death benefits with respect to the contract.

Reporting with respect to reportable death benefits

When a reportable death benefit is paid under a life insurance contract, the payor insurance company is required to report information about the payment to the IRS and to the payee. Under this reporting requirement, the payor reports (1) the gross amount of the payment; (2) the taxpayer identification number of the payee; and (3) the payor's estimate of the buyer's basis in the contract. A reportable death benefit means an amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale.

For purposes of these reporting requirements, a payment means the amount of cash and the fair market value of any consideration transferred in a reportable policy sale.

Determination of basis

The provision provides that in determining the basis of a life insurance or annuity contract, no adjustment is made for mortality, expense, or other reasonable charges incurred under the contract (known as "cost of insurance"). This reverses the position of the IRS in Revenue Ruling 2009-13 that on sale of a cash value life insurance contract, the insured's (seller's) basis is reduced by the cost of insurance.

Scope of transfer for value rules

The provision provides that the exceptions to the transfer for value rules do not apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. Thus, some portion of the death benefit ultimately payable under such a contract may be includable in income.

Effective Date

Under the provision, the reporting requirement is effective for reportable policy sales occurring after December 31, 2017, and reportable death benefits paid after December 31, 2017. The clarification of the basis rules for life insurance and annuity contracts is effective for transactions entered into after August 25, 2009. The modification of exception to the transfer for value rules is effective for transfers occurring after December 31, 2017.

J. Partnerships

1. Tax gain on the sale of a partnership interest on look-through basis

Present Law

In general

A partnership generally is not treated as a taxable entity, but rather, income of the partnership is taken into account on the tax returns of the partners. The character (as capital or ordinary) of partnership items passes through to the partners as if the items were realized directly by the partners.[476] A partner holding a partnership interest includes in income its distributive share (whether or not actually distributed) of partnership items of income and gain, including capital gain eligible for the lower tax rates, and deducts its distributive share of partnership items of deduction and loss. A partner's basis in the partnership interest is increased by any amount of gain and decreased by ay amount of losses thus included. These basis adjustments prevent double taxation of partnership income to the partner. Money distributed to the partner by the partnership is taxed to the extent the amount exceeds the partner's basis in the partnership interest.

Gain or loss from the sale or exchange of a partnership interest generally is treated as gain or loss from the sale or exchange of a capital asset.[477] However, the amount of money and the fair market value of property received in the exchange that represent the partner's share of certain ordinary income-producing assets of the partnership give rise to ordinary income rather than capital gain.[478] In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election to do so,[479] or the partnership has a substantial built-in loss immediately after the transfer.[480] If an election is in effect or the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee partner's basis in its partnership interest.[481] The effect of the adjustments on the basis of partnership property is to approximate the result of a direct purchase of the property by the transferee partner.

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[476] Sec. 702.

[477] Sec. 741; *Pollack v. Commissioner*, 69 T.C. 142 (1977).

[478] Sec. 751(a). These ordinary income-producing assets are unrealized receivables of the partnership or inventory items of the partnership ("751 assets").

[479] Sec. 754.

[480] Sec. 743(a).

[481] Sec. 743(b).

Source of gain or loss on transfer of a partnership interest

A foreign person that is engaged in a trade or business in the United States is taxed on income that is "effectively connected" with the conduct of that trade or business ("effectively connected gain or loss").[482] Partners in a partnership are treated as engaged in the conduct of a trade or business within the United States if the partnership is so engaged.[483] Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is not taken into account in determining the rates of U.S. tax applicable to the person's income from the business.[484]

Among the factors taken into account in determining whether income, gain, or loss is effectively connected gain or loss are the extent to which the income, gain, or loss is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the income, gain, or loss (the "asset use" and "business activities" tests).[485] In determining whether the asset use or business activities tests are met, due regard is given to whether such assets or such income, gain, or loss were accounted for through such trade or business. Thus, notwithstanding the general rule that source of gain or loss from the sale or exchange of personal property is generally determined by the residence of the seller,[486] a foreign partner may have effectively connected income by reason of the asset use or business activities of the partnership in which he is an investor.

Special rules apply to treat gain or loss from disposition of U.S. real property interests as effectively connected with the conduct of a U.S. trade or business.[487] To the extent that consideration received by the nonresident alien or foreign corporation for all or part of its interest in a partnership is attributable to a U.S. real property interest, that consideration is considered to be received from the sale or exchange in the United States of such property.[488] In certain

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[482] Secs. 871(b), 864(c), 882.

[483] Sec. 875.

[484] Secs. 871(b)(2), and 882(a)(2). Non-business income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30 percent, and is collected by withholding at the source of the payment. The income of non-resident aliens or foreign corporations that is subject to tax at a rate of 30-percent is fixed, determinable, annual or periodical income that is not effectively connected with the conduct of a U.S. trade or business.

[485] Sec. 864(c)(2).

[486] Sec. 865(a).

[487] Sec. 897(a), (g).

[488] Sec. 897(g).

circumstances, gain attributable to sales of U.S. real property interests may be subject to withholding tax of ten percent of the amount realized on the transfer.[489]

Under a 1991 revenue ruling, in determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS applied the asset-use test and business activities test at the partnership level to determine the extent to which income derived from the sale or exchange is effectively connected with that U.S. business.[490] Under the ruling, if there is unrealized gain or loss in partnership assets that would be treated as effectively connected with the conduct of a U.S. trade or business if those assets were sold by the partnership, some or all of the foreign person's gain or loss from the sale or exchange of a partnership interest may be treated as effectively connected with the conduct of a U.S. trade or business. However, a 2017 Tax Court case rejects the logic of the ruling and instead holds that, generally, gain or loss on sale or exchange by a foreign person of an interest in a partnership that is engaged in a U.S. trade or business is foreign-source.[491]

Description of Proposal

Under the proposal, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The proposal requires that any gain or loss from the hypothetical asset sale by the partnership be allocated to interests in the partnership in the same manner as nonseparately stated income and loss.

The proposal also requires the transferee of a partnership interest to withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold.

The proposal provides the Secretary of the Treasury with specific regulatory authority to address coordination with the nonrecognition provisions of the Code.

Effective Date

The proposal is effective for sales and exchanges after December 31, 2017.

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[489] Sec. 1445(e)(5). Temp. Treas. Reg. sec. 1.1445-11T(b),(d).

[490] Rev. Rul. 91-32, 1991-1 C.B. 107.

[491] *See Grecian Magnesite Mining v. Commissioner*, 149 T.C. No. 3 (July 13, 2017).

2. Modification of the definition of substantial built-in loss in the case of transfer of partnership interest

Present Law

In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under section 754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer.[492]

If an election is in effect, or if the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest.[493] The adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner.

Under the provision, a substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property.[494] Certain securitization partnerships and electing investment partnerships are not treated as having a substantial built-in loss in certain instances, and thus are not required to make basis adjustments to partnership property.[495] For electing investment partnerships, in lieu of the partnership basis adjustments, a partner-level loss limitation rule applies.[496]

Description of Proposal

The proposal modifies the definition of a substantial built-in loss for purposes of section 743(d), affecting transfers of partnership interests. Under the proposal, in addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

For example, a partnership of three taxable partners (partners A, B, and C) has not made an election pursuant to section 754. The partnership has two assets, one of which, Asset X, has a built-in gain of $1 million, while the other asset, Asset Y, has a built-in loss of $900,000.

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[492] Sec. 743(a).

[493] Sec. 743(b).

[494] Sec. 743(d).

[495] See sec. 743(e) (alternative rules for electing investment partnerships) and sec. 743(f) (exception for securitization partnerships).

[496] Unlike in the case of an electing investment partnership, the partner-level loss limitation rule does not apply for a securitization partnership.

Pursuant to the partnership agreement, any gain on sale or exchange of Asset X is specially allocated to partner A. The three partners share equally in all other partnership items, including in the built-in loss in Asset Y. In this case, each of partner B and partner C has a net built-in loss of $300,000 (one third of the loss attributable to asset Y) allocable to his partnership interest. Nevertheless, the partnership does not have an overall built-in loss, but a net built-in gain of $100,000 ($1 million minus $900,000). Partner C sells his partnership interest to another person, D, for $33,333. Under the proposal, the test for a substantial built-in loss applies both at the partnership level and at the transferee partner level. If the partnership were to sell all its assets for cash at their fair market value immediately after the transfer to D, D would be allocated a loss of $300,000 (one third of the built-in loss of $900,000 in Asset Y). The partnership does not have a substantial built-in loss, but a substantial built-in loss exists under the partner-level test, and the partnership adjusts the basis of its assets accordingly with respect to D.

Effective Date

The proposal applies to transfers of partnership interests after December 31, 2017.

3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss

Present Law

A partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis (before reduction by current year's losses) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred. Any disallowed loss is allowable as a deduction at the end of the first succeeding partnership taxable year, and subsequent taxable years, to the extent that the partner's adjusted basis for its partnership interest at the end of any such year exceeds zero (before reduction by the loss for the year).[497]

A partner's basis in its partnership interest is increased by its distributive share of income (including tax exempt income) and is decreased (but not below zero) by distributions by the partnership and its distributive share of partnership losses and expenditures of the partnership not deductible in computing partnership taxable income and not properly chargeable to capital account.[498] In the case of a charitable contribution, a partner's basis is reduced by the partner's distributive share of the adjusted basis of the contributed property.[499]

A partnership computes its taxable income in the same manner as an individual with certain exceptions. The exceptions provide, in part, that the deductions for foreign taxes and

[497] Sec. 704(d) and Treas. Reg. sec. 1.704-1(d)(1).

[498] Sec. 705(a).

[499] Rev. Rul. 96-11, 1996-1 C. B. 140.

charitable contributions are not allowed to the partnership.[500] Instead, a partner takes into account its distributive share of the foreign taxes paid by the partnership and the charitable contributions made by the partnership for the taxable year.[501]

In applying the basis limitation on partner losses, Treasury regulations do not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued.[502] The IRS has taken the position in a private letter ruling that the basis limitation on partner losses does not apply to limit the partner's deduction for its share of the partnership's charitable contributions.[503] While the regulations relating to the loss limitation do not mention the foreign tax credit, a taxpayer may choose the foreign tax credit in lieu of deducting foreign taxes.[504]

By contrast, under S corporation rules limiting the losses and deductions which may be taken into account by a shareholder of an S corporation to the shareholder's basis in stock and debt of the corporation, the shareholder's pro rata share of charitable contributions and foreign taxes are taken into account.[505]

Description of Proposal

The proposal modifies the basis limitation on partner losses to provide that a partner's distributive share of items that are not deductible in computing the partnership's taxable income, and not properly chargeable to capital account, are allowed only to the extent of the partner's

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[500] Sec. 703(a)(2)(B) and (C). In addition, section 703(a)(2) provides that other deductions are not allowed to the partnership, notwithstanding that the partnership's taxable income is computed in the same manner as an individual's taxable income, specifically: personal exemptions, net operating loss deductions, certain itemized deductions for individuals, or depletion.

[501] Sec. 702.

[502] The regulation provides that "[i]f the partner's distributive share of the aggregate of items of loss specified in section 702(a)(1), (2), (3), (8) [now (7)], and (9) [now (8)] exceeds the basis of the partner's interest computed under the preceding sentence, the limitation on losses under section 704(d) must be allocated to his distributive share of each such loss." The regulation does not refer to section 702(a)(4) (charitable contributions) and 702(a)(6) (foreign taxes paid or accrued). Treas. Reg. sec. 1.704-1(d)(2).

[503] Priv. Ltr. Rul. 8405084. And see William S. McKee, William F. Nelson and Robert L. Whitmire, *Federal Taxation of Partnerships and Partners*, WG&L, 4th Edition (2011), paragraph 11.05[1][b], pp. 11-214 (noting that the "failure to include charitable contributions in the § 704(d) limitation is an apparent technical flaw in the statute. Because of it, a zero-basis partner may reap the benefits of a partnership charitable contribution without an offsetting decrease in the basis of his interest, whereas a fellow partner who happens to have a positive basis may do so only at the cost of a basis decrease.").

[504] Sec. 901.

[505] Sec. 1366(d) and sec. 1366(a)(1). In connection with the application of the section 1366(d) limitation to charitable contributions, section 1366(d)(4) provides a special rule prorating the amount of appreciation not subject to the limitation in the case of charitable contributions of appreciated property by the S corporation. Under a related rule, the shareholder's basis in his interest is decreased by the basis (rather than the fair market value) of appreciated property by reason of a charitable contribution of the property by the S corporation (temporarily through 2013) (sec. 1367(a)(2)).

adjusted basis in its partnership interest at the end of the partnership taxable year in which the expenditure occurs. Thus, the basis limitation on partner losses applies to a partner's distributive share of charitable contributions and foreign taxes.

Effective Date

The proposal applies to partnership taxable years beginning after December 31, 2017.

K. Determination of Worker Classification and Information Reporting Requirements

Present Law

Worker classification

In general

The classification of a worker as an employee or not as an employee (that is, a self-employed individual in most cases) is relevant for many tax purposes. These purposes include employment tax requirements, exclusions from gross income for certain types of compensation, and expense deductions. Some purposes favor employee status, while others favor self-employed status. For example, an employee may exclude employer-provided health benefits from gross income. On the other hand, a self-employed individual may deduct work-related expenses in determining adjusted gross income.

Common-law test and section 530 of the Revenue Act of 1978

The largest body of tax law relating to worker classification has developed in connection with employment taxes.[506] Employment tax responsibility generally rests with the person who is the employer of an employee under a common-law test that has been incorporated into Treasury regulations.[507] Under the regulations, an employer-employee relationship generally exists if the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer, not only as to what is to be done, but also as to how it is to be done. It is not necessary that the employer actually control the manner in which the services are performed, rather it is sufficient that the employer have a right to control. Whether the requisite control exists is determined on the basis of all the relevant facts and circumstances.

Various cases and administrative guidance have identified various facts or factors that are relevant in determining whether an employer-employee relationship exists. Based on an examination of cases and rulings, the Internal Revenue Service ("IRS") developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists.[508] The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed.

[506] Employment taxes consist of taxes under the Federal Insurance Contributions Act ("FICA"), secs. 3101-3128, the Railroad Retirement Tax Act ("RRTA"), secs. 3201-3233, and the Federal Unemployment Tax Act ("FUTA"), secs. 3301-3311, and required income tax withholding, secs. 3401-3404.

[507] Treas. Reg. secs. 31.3121(d)-1(c)(1), 31.3306(i)-1(a), and 31.3401(c)-1.

[508] Rev. Rul. 87-41, 1987-1 C.B. 296. The 20 factors identified by the IRS are: (1) instructions, (2) training, (3) integration of the worker's services into business operations, (4) services to be rendered personally, (5) hiring, supervision, and paying assistants, (6) continuing relationship, (7) set hours of work, (8) full-time services required, (9) work on service recipient's premises, (10) required order or sequence of work, (11) oral or written

More recently, the IRS has identified three categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories: (1) behavioral control; (2) financial control; and (3) relationship of the parties.[509] The IRS emphasizes that factors in addition to the 20 identified factors may be relevant, that the weight of the factors may vary based on the circumstances, that relevant factors may change over time, and that all facts must be examined.

Generally, individuals who follow an independent trade, business, or profession in which they offer services to the public are not employees. Courts have recognized that a highly educated or skilled worker does not require close supervision; therefore, the degree of day-to-day control over the worker's performance of services is not particularly helpful in determining the worker's status. Courts have considered other factors in these cases, tending to focus on the individual's ability to realize a profit or suffer a loss as evidenced by business investments and expenses.

Under section 530 of the Revenue Act of 1978[510] ("section 530"), if certain requirements are met, a taxpayer may generally treat a worker as not being an employee for employment tax purposes, regardless of the worker's actual status under the common-law test, unless the taxpayer has no reasonable basis for such treatment. For this purpose, a reasonable basis exists if the taxpayer reasonably relied on (1) past IRS audit practice with respect to the taxpayer, (2) published rulings or judicial precedent, (3) long-standing recognized practice in the industry of which the taxpayer is a member, or (4) any other reasonable basis. Relief under section 530 also requires that the taxpayer not have treated the worker as an employee for any period, and, for periods after 1978, all Federal tax returns, including information returns, must have been filed on a basis consistent with treating the worker as not being an employee. Further, the taxpayer (or a predecessor) must not have treated any worker holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after 1977.

Section 530 also generally prohibits Treasury and the IRS from publishing regulations and revenue rulings with respect to the employment status of any individual for employment tax purposes. However, a service provider or service recipient may generally obtain a written

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reports required, (12) payment by the hour, week, or month, (13) payment of business or travel expenses, (14) furnishing of tools and materials by service recipient, (15) significant investment by the worker, (16) ability to realize a profit or loss by the worker, (17) working for more than one firm at a time, (18) services available to the general public, (19) service recipient has right to discharge, and (20) worker has right to terminate relationship.

[509] Department of the Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 84238I, pp. 2-7. This document is publicly available through the IRS website.

[510] Pub. L. No. 95-600. The relief provided under section 530 was initially temporary to give Congress time to resolve the many complex issues regarding worker classification. However, after being extended more than once, it was made permanent and has been amended several times over the years.

determination from the IRS regarding the status of a particular worker as an employee or independent contractor for purposes of Federal employment taxes and income tax withholding.[511]

Statutory employee or nonemployee status

The Code contains various provisions that prescribe treatment of a specific category or type of worker as an employee or as not being an employee. Some of these provisions apply for Federal tax purposes generally; for example, certain real estate agents and direct sellers are treated for all tax purposes as not being employees.[512] Others apply only for specific purposes; for example, full-time life insurance salesmen are treated as employees for social security and Medicare tax and employee benefit purposes,[513] and certain other salesmen are treated as employees for social security and Medicare tax purposes.[514]

Reporting requirements

Returns relating to payments made of fixed or determinable income or compensation and relating to payments for services

Present law imposes a variety of information reporting requirements on participants in certain transactions.[515] These requirements are intended to assist taxpayers in preparing their income tax returns and to help the Internal Revenue Service ("IRS") determine whether such returns are correct and complete.

The primary provision governing information reporting by payors requires an information return by every person engaged in a trade or business who makes payments aggregating $600 or more in any taxable year to a single payee in the course of the payor's trade or business.[516] Payments to corporations generally are excepted from this requirement. Payments subject to reporting include fixed or determinable income or compensation, but do not include payments for goods or certain enumerated types of payments that are subject to other specific reporting

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[511] IRS Form SS-8 (Rev. 11-2006). A written determination with regard to prior employment status may be issued by the IRS. The IRS will not issue a written determination with respect to prospective employment status. Section 3.01(104) of Rev. Proc. 2017-3, 2017-1 I.R.B. 130, 136. Under section 7436, if the IRS determines that a worker is an employee for employment tax purposes of the person for whom services are performed, or that the person is not entitled to relief under section 530, the person may petition the Tax Court for a determination of whether the IRS determination is correct and the proper amount of employment tax.

[512] Sec. 3508.

[513] Secs. 3121(d)(3)(B) and 7701(a)(20).

[514] Sec. 3121(d)(3)(D).

[515] Secs. 6031 through 6060.

[516] The information return generally is submitted electronically as a Form 1099 or Form 1096, although certain payments to beneficiaries or employees may require use of Form 1041 or Forms W-2 and W-3, respectively. Treas. Reg. sec. 1.6041-1(a)(2).

requirements.[517] Detailed rules are provided for the reporting of various types of investment income, including interest, dividends, and gross proceeds from brokered transactions (such as a sale of stock) paid to U.S. persons.[518]

Special information reporting requirements exist for employers required to deduct and withhold tax from employees' income.[519] In addition, any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when the aggregate of payments is $600 or more.[520]

The payor of amounts described above is required to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor.[521] The statement must be supplied to taxpayers by the payors by January 31 of the following calendar year. Payors generally must file the information return with the IRS on or before January 31 of the year following the calendar year to which such returns relate.[522]

Returns relating to payments made in settlement of third party network transactions

Any payment settlement entity making payment to a participating payee in settlement of reportable payment transactions must report annually to the IRS and to the participating payee the gross amount of such reportable payment transactions, as well as the name, address, and TIN of the participating payees. A "reportable payment transaction" means any payment card transaction and any third party network transaction.

A "payment settlement entity" means, in the case of a payment card transaction, a merchant acquiring entity and, in the case of a third party network transaction, a third party settlement organization. A "participating payee" means, in the case of a third party network transaction, any person who accepts payment from a third party settlement organization in settlement of such transaction.

For purposes of the reporting requirement, the term "third party network transaction" means any transaction which is settled through a third party payment network. A "third party payment network" is defined as any agreement or arrangement (1) which involves the establishment of accounts with a central organization by a substantial number of persons (*i.e.*,

[517] Sec. 6041(a) requires reporting as to fixed or determinable gains, profits, and income (other than payments to which secs. 6042(a)(1), 6044(a)(1), 6047(c), 6049(a), or 6050N(a) applies and other than payments with respect to which a statement is required under authority of section 6042(a), 6044(a)(2) or 6045). These payments excepted from section 6041(a) include most interest, royalties, and dividends.

[518] Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest) and the Treasury regulations thereunder.

[519] Sec. 6051(a).

[520] Sec. 6041A.

[521] Secs. 6041(d), 6041A(e).

[522] Sec. 6071(c).

more than 50) who are unrelated to such organization, provide goods or services, and have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (2) which provides for standards and mechanisms for settling such transactions; and (3) which guarantees persons providing goods or services pursuant to such agreement or arrangement that such persons will be paid for providing such goods or services. In the case of a third party network transaction, the payment settlement entity is the third party settlement organization, which is defined as the central organization which has the contractual obligation to make payment to participating payees of third party network transactions. Thus, an organization generally is required to report if it provides a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network. However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report under the provision. Similarly, an agreement to transfer funds between two demand deposit accounts will not, by itself, constitute a third party network transaction.

A third party payment network does not include any agreement or arrangement which provides for the issuance of payment cards. In addition, a third party settlement organization is not required to report unless the aggregate value of third party network transactions for the year exceeds $20,000 and the aggregate number of such transactions exceeds 200.[523] If a payment of funds is made to a third party settlement organization by means of a payment card (*e.g.*, as part of a transaction that is a payment card transaction), the $20,000 and 200 transaction *de minimis* rule continues to apply to any reporting obligation with respect to payment of such funds to a participating payee by the third party settlement organization made as part of a third party network transaction.

Description of Proposal

Worker classification safe harbor

In general

The proposal provides a safe harbor under which, for all Code purposes (and notwithstanding any Code provision to the contrary), if certain requirements are met with respect to service performed by a service provider, with respect to such service: (1) the service provider is not treated as an employee, (2) the service recipient is not treated as an employer, (3) a payor is not treated as an employer, and (4) the compensation paid or received for the service is not treated as paid or received with respect to employment.[524]

[523] Sec. 6050W(e).

[524] The proposal also amends the direct seller rules under section 3508 to include a person engaged in the trade or business of selling, or soliciting the sale of, promotional products from other than a permanent retail establishment. For this purpose, a promotional product is a tangible item with permanently marked promotional words, symbols, or art of the purchaser.

For purposes of the proposal, a service provider is any qualified person who performs service for another person, and a qualified person is any natural person or any entity if any of the services performed for another person are performed by one or more natural persons who directly own interests in such entity. The service recipient is the person for whom the service provider performs service. A payor is a person (including the service recipient) that pays the service provider for performing the service, or any marketplace platform which is any person who operates a digital website or mobile application that facilitates the provision of goods or services by providers to recipients, who enters into an agreement with each provider that such provider will not be treated as an employee with respect to such goods and services, who provides standards and mechanisms for settling such transactions, and guarantees each service provider of payment for transactions.[525]

The proposal does not apply with respect to any service provided by a service provider to a service recipient or payor if the service provider owns any interest in the service recipient or payor, with the exception of a service recipient or payor, the stock of which is regularly traded on an established securities market.

Under the proposal, notwithstanding section 530 of the Revenue Act of 1979, the Secretary of the Treasury is directed to issue such regulations as the Secretary determines are necessary to carry out the purposes of the proposal. Nothing in the proposal is to be construed as limiting the ability or right of a service provider, service recipient, or payor to apply any other Code provision, section 530, or any common law rules for determining whether an individual is an employee, or as establishing a prerequisite for the application of any of those areas of law.

Service provider requirements

In order for this treatment to apply to service, in connection with performing the service, the service provider generally must (1) incur expenses which are deductible as trade or business expenses and a significant portion of which are reimbursed; (2) agree to perform the service for a particular amount of time, to achieve a specific result, or to complete a specific task; (3) have a significant investment in assets or training applicable to the service performed, not be required to perform services exclusively for the service recipient, have not performed substantially the same services for the service recipient or payor as an employee during the one-year period ending with the date of commencement of services under a contract meeting the requirements described below, or not be compensated on a basis which is tied primarily to the number of hours actually worked. Alternatively, in the case of a service provider engaged in the trade or business of selling (or soliciting the sale of) goods or services, the service provider must be compensated primarily on a commission basis, and substantially all the compensation for the service must be directly related to sales of goods or services rather than to the number of hours worked. In addition, any service provider must have a principal place of business, must not primarily provide the service in the service recipient's place of business, must pay a fair market rent for use of the service recipient's place of business, or must provide the service primarily using equipment supplied by the service provider.

[525] The proposal amends section 7436 to allow a petition to be filed by a service recipient, a payor, or a service provider whom the IRS has determined should have been treated as an employee.

Contract and reporting requirements

The service performed by the service provider must be pursuant to a written contract between the service provider and the service recipient (or the payor, if applicable) that meets certain requirements. First, the contract must include the service provider's name, taxpayer identification number, and address; a statement that the service provider will not be treated as an employee for purposes of the Code with respect to the service provided pursuant to the contract; a statement that the service recipient (or the payor) will, consistent with Code requirements, withhold on and report to the IRS the compensation payable pursuant to the contract; a statement that the service provider is responsible for the payment of Federal, State, and local taxes, including self-employment taxes, on compensation payable pursuant to the contract; and a statement that the contract is intended to be a contract meeting the applicable requirements. The contract does not fail to meet these requirements merely because the service provider's name, taxpayer identification number, and address are collected at the time of payment for the services and not in advance, or because the contract provides for an agent of the service recipient or payor to fulfill the responsibilities of the service recipient or payor. Second, the term of the contract generally must not exceed two years; however, a contract can be renewed in writing one or more times if the term of each renewal does not exceed two years and if the required information in the contract is updated in connection with the renewal. Third, the contract or renewal must be signed, including electronically, by both the service recipient or payor and the service provider no later than the date on which aggregate payments made by the service recipient to the service provider exceed $1000.

If, for a taxable year, the service recipient or payor fails to meet the reporting requirements applicable with respect to any service provider ("applicable" reporting requirements),[526] the safe harbor does not apply for purposes of making any determination with respect to the tax liability of the service recipient or payor with respect to such service provider for the year (unless the failure is due to reasonable cause and not willful neglect).

Prospective application of reclassification

In the case of a determination by the IRS that a service recipient or a payor should have treated a service provider as an employee, if certain requirements are met, the determination will not be effective earlier than the "notice date." In order for this rule to apply, the service recipient or payor must have entered into a written contract with the service provider that meets the requirements described above, for all relevant taxable years the service recipient or the payor must have satisfied the applicable withholding and reporting requirements with respect to the

[526] The applicable reporting requirements relate to, under section 6041(a), a person engaged in a trade or business that makes payments of $600 or more ($1,000 or more under the proposal, as discussed below) to another person, under section 6041A(a), a service recipient engaged in a trade or business that pays $600 or more ($1,000 or more under the proposal, as discussed below) in remuneration to another person for services, or under section 6050W(a), a marketplace platform settling payments above the minimum threshold with a provider of goods or services engaging in third party network transactions. Under the proposal, reporting by a service recipient or payor required under section 6041 or 6041A with respect to compensation paid under the proposal must include the aggregate amount of such compensation paid to each person whose name is required to be included on the report, the aggregate amount of income tax withheld from the compensation (as discussed below), and an indication of whether a copy of the contract required under the proposal is on file with the service recipient or payor.

service provider (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect), the service recipient or payor must have collected and paid over all applicable employment taxes for all relevant taxable years with respect to the service provider (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect), and the service recipient or the payor must demonstrate a reasonable basis for determining that the service provider is not an employee under the safe harbor and that the determination was made in good faith.

Similarly, with respect to the service provider, a determination that the service provider should have been treated as an employee will not be effective earlier than the notice date if the service provider entered into a written contract with the service recipient or payor that meets the requirements described above, for all relevant taxable years the service provider satisfied applicable income tax and self-employment tax return requirements[527] with respect to the service recipient or payor (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect), and the service provider demonstrates a reasonable basis for determining that the service provider is not an employee under the safe harbor and that the determination was made in good faith.

For this purpose, the "notice date" is the 30th day after the earlier of (1) the date on which the first letter of proposed deficiency that allows the service provider, service recipient, or payor an opportunity for administrative review in the IRS Office of Appeals is sent, (2) the date on which a deficiency notice is sent, or (3) the date on which a notice of determination that a service provider is an employee is sent.

Withholding requirements

The proposal imposes an income tax withholding requirement with respect to compensation paid pursuant to a contract between a service provider and a service recipient (or payer) that meets the requirements described above. For this purpose, a payment of such compensation is treated as a payment of wages by an employer to an employee. However, the amount required to be withheld is five percent of the compensation and only on compensation up to $20,000 paid pursuant to the contract. [528]

Reporting requirements

Returns relating to payments made of fixed or determinable income a compensation and relating to payments for services

This proposal increases the reporting threshold for two categories of reportable payments from aggregate payments of $600 or more to $1000 or more. The first category is payments of fixed or determinable income or compensation not including payments for goods or certain

[527] Secs. 6012(a) and 6017.

[528] The proposal also amends the voluntary withholding rules under section 3402(p) to provide that a voluntary withholding agreement is not taken into account in determining whether any party to the agreement is an employee or an employer for Code purposes.

enumerated types of payments subject to other reporting requirements. The second category is payments for services received from any service recipient engaged in a trade or business paying for such services.

Returns relating to payments made in settlement of third party network transactions

This proposal defines a marketplace platform as a person which is a central organization and who operates a website, mobile application, or similar system through which users may transact for the provision of goods or services to recipients and through which the organization settles such transactions and guarantees payments to providers. In the agreement with each provider, the central organization classified as a marketplace platform must state that the provider will not be treated as an employee with respect to their provision of goods or services.

This proposal also changes the *de minimis* rule for aggregate third party network transactions to a participating payee below which a third party settlement organization is not required to report. A third party settlement organization is generally required to report third party network transactions with any participating payee that exceed a minimum threshold of $1,000 in aggregate payments, regardless of the aggregate number of such transactions.

Certain third party settlement organizations may instead elect to report once third party network transactions with a participating payee either exceed $5,000 or exceed 50 in number, whichever occurs first. Third party settlement organizations that are marketplace platforms may opt to report using the higher threshold if substantially all of the participating payees to which it makes reportable payments are primarily engaged in the sale of goods on such platform. Third party settlement organizations that are not marketplace platforms may opt to report using the higher threshold third party network transactions with participating payees who are primarily engaged in the sale of goods in these transactions.

Effective Date

Worker classification

The proposal is generally effective for services performed after December 31, 2017, and amounts paid for such services after such date. However, a contract, and a service recipient or payor, will not be treated as failing to meet the requirements under the proposal with respect to compensation paid to a service provider before 180 days after the date of enactment of the proposal.

Reporting requirements

The proposal applies to payments made after December 31, 2018.

L. Tax-Exempt Organizations

1. Excise tax based on investment income of private colleges and universities

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[529] Certain organizations are classified as public charities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.[530] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[531] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[532] A supporting organization, *i.e.*, an organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets the requirements of the Code, also is classified as a public charity.[533]

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[529] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[530] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[531] Treas. Reg. sec. 1.170A-9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A-9(f)(3).

[532] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[533] Sec. 509(a)(3). Supporting organizations are further classified as Type I, II, or III depending on the relationship they have with the organizations they support. Supporting organizations must support public charities listed in one of the other categories (*i.e.*, *per se* public charities, broadly supported public charities, or revenue generating public charities), and they are not permitted to support other supporting organizations or testing for public safety organizations.

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities.[534]

Excise tax on investment income of private foundations

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations)[535] are subject to a two-percent excise tax on their net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[536] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[537] In addition, the foundation cannot have been

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Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

534 Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year, (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

535 Exempt operating foundations are exempt from the section 4940 tax. Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

536 Sec. 4942(g).

537 Sec. 4940(e).

subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[538]

Private colleges and universities

Private colleges and universities generally are treated as public charities rather than private foundations[539] and thus are not subject to the private foundation excise tax on net investment income.

Description of Proposal

The proposal imposes an excise tax on an applicable educational institution for each taxable year equal to 1.4 percent of the net investment income of the institution for the taxable year. Net investment income is determined using rules similar to the rules of section 4940(c) (relating to the net investment income of a private foundation).

For purposes of the proposal, an applicable educational institution is an institution: (1) that has at least 500 tuition-paying students during the preceding taxable year; (2) that is an eligible education institution as described in section 25A of the Code[540]; (3) that is not described in the first section of section 511(a)(2)(B) of the Code (generally describing State colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution's exempt purpose[541]) is at least $250,000 per student. For these purposes, the number

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[538] Sec. 4942(d)(2).

[539] Secs. 509(a)(1) and 170(b)(1)(A)(ii).

[540] Section 25A defines an eligible educational institution as an institution (1) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1977, and (2) which is eligible to participate in a program under title IV of such Act.

[541] Assets used directly in carrying out the institution's exempt purpose include, for example, classroom buildings and physical facilities used for educational activities and office equipment or other administrative assets used by employees of the institution in carrying out exempt activities, among other assets.

of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students being taken into account on a full-time student equivalent basis.

For purposes of determining whether an institution meets the asset-per-student threshold and determining net investment income, assets and net investment income include amounts with respect to an organization that is related to the institution. An organization is treated as related to the institution for this purpose if the organization: (1) controls, or is controlled by, the institution; (2) is controlled by one or more persons that control the institution; or (3) is a supported organization[542] or a supporting organization[543] during the taxable year with respect to the institution.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Name and logo royalties treated as unrelated business taxable income

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

An exempt organization generally may have revenue from four sources: contributions, gifts, and grants; trade or business income that is related to exempt activities (*e.g.*, program service revenue); investment income; and trade or business income that is not related to exempt activities. The Federal income tax exemption generally extends to the first three categories, and does not extend to an organization's unrelated trade or business income. In some cases, however, the investment income of an organization is taxed as if it were unrelated trade or business income.[544]

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[542] Secs. 509(f)(3).

[543] Secs. 509(a)(3).

[544] This is the case for social clubs (sec. 501(c)(7)), voluntary employees' beneficiary associations (sec. 501(c)(9)), and organizations and trusts described in sections 501(c)(17) and 501(c)(20). Sec. 512(a)(3).

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[545] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[546] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts);[547] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[548] and (3) certain State colleges and universities.[549]

Exclusions from unrelated business taxable income

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[550] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[551] Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may

[545] Secs. 511-514.

[546] Treas. Reg. sec. 1.501(c)(3)-1(e).

[547] Sec. 511(a)(2)(A).

[548] Sec. 511(a)(2)(A).

[549] Sec. 511(a)(2)(B).

[550] Secs. 511-514.

[551] Sec. 512(b)(13).

be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Description of Proposal

The proposal modifies the UBIT treatment of the licensing of an organization's name or logo generally to subject royalty income derived from such a license to UBIT. Specifically, the proposal amends section 513 (regarding unrelated trades or businesses) to provide that any sale or licensing by an organization of any name or logo of the organization (including any trademark or copyright related to a name or logo) is treated as an unrelated trade or business that is regularly carried on by the organization. In addition, the proposal amends section 512 (regarding unrelated business taxable income) to provide that income derived from any such licensing of a name or logo of the organization is included in the organization's gross unrelated business taxable income, notwithstanding the provisions of section 512 that otherwise exclude certain types of passive income (including royalties) from unrelated business taxable income.[552]

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Unrelated business taxable income separately computed for each trade or business

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

An exempt organization generally may have revenue from four sources: contributions, gifts, and grants; trade or business income that is related to exempt activities (*e.g.*, program service revenue); investment income; and trade or business income that is not related to exempt activities. The Federal income tax exemption generally extends to the first three categories, and does not extend to an organization's unrelated trade or business income. In some cases,

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[552] Specifically, the proposal references sections 512(b)(1), (2), (3) and (5).

however, the investment income of an organization is taxed as if it were unrelated trade or business income.[553]

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[554] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[555] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts) ;[556] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[557] and (3) certain State colleges and universities.[558]

Exclusions from unrelated business taxable income

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[559] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[560] Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income

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[553] This is the case for social clubs (sec. 501(c)(7)), voluntary employees' beneficiary associations (sec. 501(c)(9)), and organizations and trusts described in sections 501(c)(17) and 501(c)(20). Sec. 512(a)(3).

[554] Secs. 511-514.

[555] Treas. Reg. sec. 1.501(c)(3)-1(e).

[556] Sec. 511(a)(2)(A).

[557] Sec. 511(a)(2)(A).

[558] Sec. 511(a)(2)(B).

[559] Secs. 511-514.

[560] Sec. 512(b)(13).

from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Specific deduction against unrelated business taxable income

In computing unrelated business taxable income, an exempt organization may take a specific deduction of $1,000. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.[561]

In the case of a diocese, province or religious order, or a convention or association of churches, a specific deduction is allowed with respect to each parish, individual church, district, or other local unit. The specific deduction is equal to the lower of $1,000 or the gross income derived from any unrelated trade or business regularly carried on by the local unit.[562]

Operation of multiple unrelated trades or businesses

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income deductions directly connected with the unrelated trade or business.[563] Under regulations, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses aggregates income from all such activities and subtracts from the aggregate gross income the aggregate of deductions.[564] As a result, an organization may use a deduction from one unrelated trade or business to offset income from another, thereby reducing total unrelated business taxable income.

Description of Proposal

For an organization with more than one unrelated trade or business, the proposal requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction generally allowed under section 512(b)(12). The organization's unrelated business taxable income for a taxable year is the sum of the amounts (not less than zero) computed for each separate unrelated trade or business, less the specific deduction allowed under section 512(b)(12). A net operating loss deduction is allowed only with respect to a trade or business from which the loss arose.

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561 Sec. 512(b)(12).

562 *Ibid*.

563 Sec. 512(a).

564 Treas. Reg. sec. 1.512(a)-1(a).

The result of the proposal is that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. The proposal generally does not, however, prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year, where appropriate.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Repeal of tax-exempt status for professional sports leagues

Present Law

Tax exemption for section 501(c)(6) organizations

Section 501(c)(6) provides tax exempt status for business leagues and certain other organizations not organized for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual. A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit.[565] Such an organization may not have as its primary activity performing "particular services" for members.[566] Contributions to these types of organizations are not deductible as charitable contributions; however, they may be deductible as trade or business expenses if ordinary and necessary in the conduct of the taxpayer's business. Many organizations known as "trade associations" may qualify for exempt status under this provision.

Professional sports leagues

Since 1966, section 501(c)(6) has included language exempting from tax "professional football leagues (whether or not administering a pension fund for football players)." The Internal Revenue Service has interpreted this language as applying not only to professional football leagues, but to all professional sports leagues.[567]

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[565] Treas. Reg. sec. 1.501(c)(6)-1.

[566] Treas. Reg. sec. 1.501(c)(6)-1.

[567] See General Counsel Memorandum 38179, November 29, 1979 ("We continue to believe that professional sports leagues, including football leagues, do not qualify for exemption if the ordinary standards of section 501(c)(6) are applied. However, while the answer is far from clear, we have concluded upon reflection that the specific exemption of football leagues in 1966 can be viewed as providing support for recognition of exemption of all professional sports leagues as a unique category of organizations under section 501(c)(6). Since other professional sports leagues are indistinguishable in any meaningful way from football leagues, we think it is fair to conclude that by formally blessing the exemption it knew football leagues had historically enjoyed, Congress implicitly recognized a unique historical category of exemption under section 501(c)(6). The specific enumeration of football leagues can be viewed as merely exemplary of the category thus recognized, and as necessitated only by the problem of insuring that football's pension and merger arrangement would not endanger its exemption").

Description of Proposal

The proposal strikes from section 501(c)(6) the phrase "professional football leagues (whether or not administering a pension fund for football players)." In addition, the proposal amends section 501(c)(6) to provide that section 501(c)(6) "shall not apply to any professional sports league (whether or not administering a pension fund for players)."

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

5. Modification of taxes on excess benefit transactions (intermediate sanctions)

Present Law

Excess benefit transactions

The Code imposes excise taxes on excess benefit transactions between disqualified persons and charitable organizations (other than private foundations) or social welfare organizations (as described in section 501(c)(4)).[568] The excess benefit transaction tax commonly is referred to as "intermediate sanctions."[569] An excess benefit transaction generally is a transaction in which an economic benefit is provided, directly or indirectly, by a charitable or social welfare organization to or for the use of a disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. The excise tax is imposed on any such excess.

Disqualified persons

Disqualified persons generally include: (1) persons who were, at any time during the five-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization (including officers and directors); (2) a member of the family of such a person; and (3) certain 35-percent or more controlled entities.[570]

Special rules apply with respect to charities that are sponsoring organizations of donor advised funds. For such organizations, the term "disqualified person" also includes: (1) donors and certain other persons appointed by a donor to provide advice with respect to the fund (donor advisors); (2) investment advisors; and (3) members of the family and certain 35-percent or more

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[568] Sec. 4958.

[569] The excess benefit transaction rules were enacted in 1996 to provide a sanction short of revocation of tax exemption, an "intermediate" sanction, for abusive self-dealing transactions (*i.e.*, private inurement) between an organization insider and the organization. Prior to enactment of the excess benefit transaction rules, there was no sanction in the Code on organization insiders or disqualified persons for engaging in self-dealing transactions with respect to a public charity.

[570] Sec. 4958(f)(1).

controlled entities of a person described in (1) or (2).[571] An investment advisor is a person (other than an employee of the sponsoring organization) compensated by the organization for managing the investment of, or providing investment advice with respect to, assets maintained in donor advised funds owned by the organization.[572]

Rebuttable presumption of reasonableness

Under the intermediate sanctions regulations, in certain cases an exempt organization may avail itself of a rebuttable presumption with respect to compensation arrangements and property transfers. Payments under a compensation arrangement are presumed to be reasonable, and a transfer of property, or the right to use property, is presumed to be at fair market value, if: (1) the arrangement or terms of transfer are approved in advance by an authorized body of the organization (as defined below) composed entirely of individuals who do not have a conflict of interest with respect to the arrangement or transfer; (2) the authorized body obtained and relied upon appropriate data as to comparability prior to making its determination; and (3) the authorized body adequately documented the basis for its determination concurrently with making that determination.[573] If these requirements are satisfied, the IRS may overcome the presumption of reasonableness if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body.[574]

An authorized body is defined as: (1) the governing body of the organization; (2) a committee of the governing body, which may be composed of any individuals permitted under State law to serve on such a committee, to the extent that the committee is permitted by State law to act on behalf of the governing body; or (3) to the extent permitted by State law, other parties authorized by the governing body of the organization to act on its behalf by following procedures specified by the governing body in approving compensation arrangements or property transfers.[575]

In general, an authorized body has appropriate data as to comparability if, given the knowledge and expertise of its members, it has information sufficient to determine whether the arrangement is reasonable in its entirety or the transfer is at fair market value.[576] In the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the availability of similar services in the geographic area of the applicable tax-exempt organization; current compensation surveys compiled by independent firms; and actual written

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[571] Secs. 4958(f)(1)(E) and (F).

[572] Sec. 4958(f)(8).

[573] Treas. Reg. sec. 53.4958-6(a). See also H. Rep. No. 506, 104th Congress, 2d Sess. 1996, pp. 53, 56-7.

[574] Treas. Reg. sec. 53.4958-6(b).

[575] Treas. Reg. sec. 53.4958-6(c)(1)(i).

[576] Treas. Reg. sec. 53.4958-6(c)(2)(i).

offers from similar institutions competing for the services of the disqualified person. In the case of property, relevant information includes, but is not limited to, current independent appraisals of the value of all property to be transferred, and offers received as part of an open and competitive bidding process. For organizations with annual gross receipts (including contributions) of less than $1 million, the authorized body is considered to have appropriate data as to comparability if it has data on compensation paid by three comparable organizations in the same or similar communities for similar services. There is no inference with respect to whether circumstances falling outside this safe harbor will meet the requirement with respect to the collection of appropriate data.[577]

In general, for a decision to be documented adequately, the written or electronic records of the authorized body must note: (1) the terms of the transaction that was approved and the date it was approved; (2) the members of the authorized body who were present during debate on the transaction that was approved and those who voted on it; (3) the comparability data obtained and relied upon by the authorized body and how the data was obtained; and (4) any actions taken with respect to consideration of the transaction by anyone who is otherwise a member of the authorized body but who had a conflict of interest with respect to the transaction.[578]

Amount of the excise tax

The excess benefit tax is imposed on the disqualified person and, in certain cases, on the organization's managers, but is not imposed on the exempt organization.

An initial tax of 25 percent of the excess benefit amount is imposed on the disqualified person that receives the excess benefit. An additional tax on the disqualified person of 200 percent of the excess benefit applies if the violation is not corrected. A tax of 10 percent of the excess benefit (not to exceed $20,000 with respect to any excess benefit transaction) is imposed on an organization manager who knowingly participated in the excess benefit transaction, if the manager's participation was willful and not due to reasonable cause, and if the initial tax was imposed on the disqualified person.[579] If more than one person is liable for the tax on disqualified persons or on management, all such persons are jointly and severally liable for the tax.[580]

Standard for knowing violations

A manager participates in a transaction knowingly only if the manager: (1) has actual knowledge of sufficient facts indicating that, based solely upon those facts, such transaction would be an excess benefit transaction; (2) is aware that such a transaction under these

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[577] Treas. Reg. sec. 53.4958-6(c)(2)(ii).

[578] Treas. Reg. sec. 53.4958-6(c)(3).

[579] Sec. 4958(d)(2). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[580] Sec. 4958(d)(1).

circumstances may violate the provisions of Federal tax law governing excess benefit transactions; and (3) negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction, or the manager is in fact aware that it is such a transaction.[581] The burden of proof in a Tax Court proceeding as to whether an organization manager (or foundation manager) acted knowingly is on the Secretary.[582]

Knowing does not mean having a reason to know.[583] However, evidence tending to show that an organization manager has reason to know of a particular fact or particular rule is relevant in determining whether the manager had actual knowledge of such a fact or rule. Thus, for example, evidence tending to show that a manager has reason to know of sufficient facts indicating that, based solely upon such facts, a transaction would be an excess benefit transaction is relevant in determining whether the manager has actual knowledge of such facts.[584]

Participation by an organization manager is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or the incurrence of any tax is necessary to make the participation willful. Participation by an organization manager is not willful if the manager does not know that the transaction in which the manager is participating is an excess benefit transaction.[585] An organization manager's participation is due to reasonable cause if the manager has exercised responsibility on behalf of the organization with ordinary business care and prudence.[586]

Special rules

An organization manager's reliance on professional advice generally means that the manager has not knowingly participated in an excess benefit transaction. Under Treasury regulations, an organization manager's participation in a transaction ordinarily is not considered knowing, even though the transaction subsequently is held to be an excess benefit transaction, to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. A written opinion is considered as reasoned even though it reaches a conclusion that is subsequently determined to be incorrect so long as the opinion addresses itself to the facts and the applicable standards. A written opinion is not considered to be reasoned if it does nothing more than recite the facts and express a conclusion. The absence of a written opinion of an appropriate professional with respect to a

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[581] Treas. Reg. sec. 53.4958-1(d)(4)(i).

[582] Sec. 7454(b).

[583] Treas. Reg. sec. 53.4958-1(d)(4)(ii).

[584] *Ibid.*

[585] Treas. Reg. sec. 53.4958-1(d)(5).

[586] Treas. Reg. sec. 53.4958-1(d)(6).

transaction does not, by itself, give rise to any inference that an organization manager participated in the transaction knowingly.

Appropriate professionals on whose written opinion an organization manager may rely, are: (1) legal counsel, including in-house counsel; (2) certified public accountants or accounting firms with expertise regarding the relevant tax law matters; and (3) independent valuation experts who hold themselves out to the public as appraisers or compensation consultants, perform the relevant valuations on a regular basis, are qualified to make valuations of the type of property or services involved, and include in the written opinion a certification that the three preceding requirements are met.[587]

An organization manager's participation in a transaction ordinarily is not considered knowing even though the transaction subsequently is held to be an excess benefit transaction, if an appropriate authorized body that approved the transaction meets the requirements of the rebuttable presumption of reasonableness with respect to the transaction.[588]

Description of Proposal

Entity-level tax in the event of an excess benefit transaction

Under the proposal, if an initial tax is imposed on a disqualified person under the intermediate sanctions rules,[589] the organization is subject to an excise tax equal to 10 percent of the excess benefit, unless the participation of the organization in the transaction is not willful and is due to reasonable cause. No tax on the organization is imposed if the organization: (1) establishes that the minimum standards of due diligence (described below) were met with respect to the transaction; or (2) establishes to the satisfaction of the Secretary that other reasonable procedures were used to ensure that no excess benefit was provided.

Eliminate rebuttable presumption and establish due diligence procedures

The proposal eliminates the rebuttable presumption of reasonableness contained in the intermediate sanctions regulations. Under the proposal, the procedures that presently provide an organization with a presumption of reasonableness (*i.e.*, advance approval by an authorized body, reliance upon data as to comparability, and adequate and concurrent documentation) generally will establish instead that an organization has performed the minimum standards of due diligence with respect to an arrangement or transfer involving a disqualified person. Satisfaction of these minimum standards will not result in a presumption of reasonableness with respect to the transaction.

[587] Treas. Reg. sec. 53.4958-1(d)(4)(iii).

[588] Treas. Reg. sec. 53.4958-1(d)(4)(iv).

[589] Sec. 4958(a)(1).

Eliminate certain special rules for knowing behavior by organization managers

The proposal eliminates the special rule that provides that an organization manager's participation ordinarily is not "knowing" for purposes of the intermediate sanctions excise taxes if the manager relied on professional advice. Although the proposal eliminates the special rule, whether an organization manager relies on professional advice is a relevant consideration in determining the manager knowingly participated in an excess benefit transaction.

The proposal also eliminates the special regulatory rule that provides that an organization manager ordinarily does not act knowingly for purposes of the excess benefit transaction excise tax if the organization has met the requirements of the rebuttable presumption procedure.

Treat investment advisors and athletic coaches as disqualified persons

The proposal modifies the definition of a disqualified person for purposes of the intermediate sanctions rules. First, a person who performs services as an athletic coach for an organization that is an eligible educational institution (within the meaning of section 25A of the Code[590]) is treated as a disqualified person with respect to the organization. Second, the proposal (1) expands to all organizations that are subject to the intermediate sanctions rules the present-law rule that treats investment advisors to donor advised funds as disqualified persons, and (2) modifies the definition of investment advisor for this purpose. For all applicable tax-exempt organizations (including sponsoring organizations of donor advised funds), the term investment advisor means, with respect to an organization, any person compensated by the organization, and who is primarily responsible, for managing the investment of, or providing investment advice with respect to, assets of the organization.[591] For a sponsoring organization of a donor advised fund, the term investment advisor also includes any person who is an investment advisor with respect to a sponsoring organization under present law, *i.e.*, a person (other than an employee of the organization) compensated by such organization for managing the investment of, or providing investment advice with respect to, assets maintained in donor advised funds owned by the sponsoring organization.

Application of intermediate sanctions rules to section 501(c)(5) and section 501(c)(6) organizations

The proposal extends application of the section 4958 intermediate sanctions rules to tax-exempt organizations described in sections 501(c)(5) (labor and certain other organizations) and 501(c)(6) (business leagues and certain other organizations).

[590] Section 25A defines an eligible educational institution as an institution (1) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1977, and (2) which is eligible to participate in a program under title IV of such Act.

[591] Under the proposal, the existing rules that treat as disqualified persons certain family members and 35-percent controlled entities of investment advisors to sponsoring organizations of donor advised funds will apply more broadly to investment advisors that are disqualified persons with respect to any organization subject to the intermediate sanctions rules.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

6. Denial of deduction for amounts paid in exchange for college athletic seating rights

Present Law

In general

The Internal Revenue Code allows taxpayers to reduce their income tax liability by taking deductions for contributions to certain organizations, including charities, Federal, State, local and Indian tribal governments, and certain other organizations.

To be deductible, a charitable contribution generally must meet several threshold requirements. First, the recipient of the transfer must be eligible to receive charitable contributions (*i.e.*, an organization or entity described in section 170(c)). Second, the transfer must be made with gratuitous intent and without the expectation of a benefit of substantial economic value in return. Third, the transfer must be complete and generally must be a transfer of a donor's entire interest in the contributed property (*i.e.*, not a contingent or partial interest contribution). To qualify for a current year charitable deduction, payment of the contribution must be made within the taxable year.[592] Fourth, the transfer must be of money or property—contributions of services are not deductible.[593] Finally, the transfer must be substantiated and in the proper form.

Special rules limit a taxpayer's charitable contributions in a given year to a percentage of income, and those rules, in part, turn on whether the organization receiving the contributions is a public charity or a private foundation. Other special rules determine the deductible value of contributed property for each type of property.

College athletic seating rights

In general, where a taxpayer receives or expects to receive a substantial return benefit for a payment to charity, the payment is not deductible as a charitable contribution. However, special rules apply to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. Specifically, the payor may treat 80 percent of a payment as a charitable contribution where: (1) the amount is paid to or for the benefit of an institution of higher education (as defined in section 3304(f)) described in section (b)(1)(A)(ii) (generally, a school with a regular faculty and curriculum and meeting certain other requirements), and (2) such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the

[592] Sec. 170(a)(1).

[593] For example, the value of time spent volunteering for a charitable organization is not deductible. Incidental expenses such as mileage, supplies, or other expenses incurred while volunteering for a charitable organization, however, may be deductible.

payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.[594]

Description of Proposal

The proposal amends section 170(l) to provide that no charitable deduction shall be allowed for any amount described in paragraph 170(l)(2), generally, a payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event, as described in greater detail above.

Effective Date

The proposal is effective for contributions made in taxable years beginning after December 31, 2017.

[594] Sec. 170(l).

M. Retirement Savings

1. Conformity of contribution limits for employer-sponsored retirement plans

Present Law

Account-based tax-favored employer-sponsored retirement plans include a qualified defined contribution plan, a tax-sheltered annuity plan (referred to as a "section 403(b) plan"), and an eligible deferred compensation plan of a State or local government (referred to as a "governmental section 457(b) plan").[595] A qualified defined contribution plan may include a qualified cash or deferred arrangement (referred to as a "section 401(k) plan"), under which an employee elects to have contributions made to the plan (referred to as "elective deferrals") rather than receiving the same amount as cash compensation.[596] Elective deferrals are generally made on a pretax basis unless designated by the employee as Roth contributions, which are made on an after-tax basis. A defined contribution plan may also provide for after-tax employee contributions and for employer nonelective contributions and matching contributions. A section 403(b) plan may also provide for these different types of contributions. Although a governmental section 457(b) plan may provide for employer contributions, these plans generally provide only for elective deferrals.

In the case of a section 401(k) plan or a section 403(b) plan, specific annual limits apply to elective deferrals by an employee and additional annual limits apply to aggregate contributions for the employee. For 2017, elective deferrals are generally limited to the lesser of (1) $18,000 plus an additional $6,000 catch-up contribution limit for employees at least age 50 and (2) the employee's compensation.[597] If an employee participates in both a section 401(k) plan and a section 403(b) plan of the same employer,[598] a single limit applies to elective deferrals under both plans. However, under a special rule, in the case of employees who have completed 15 years of service, additional elective deferrals are permitted under a section 403(b) plan maintained by an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches.[599] In this case, the annual limit is increased by the least of (1) $3,000, (2) $15,000 reduced by the employee's additional elective deferrals for previous years, and (3) $5,000 multiplied by the employee's years of service and reduced by the employee's elective deferrals for previous years.

For 2017, the limit on aggregate contributions to a qualified defined contribution plan (including a section 401(k) plan) or a section 403(b) plan is the lesser of (1) $54,000 and (2) the

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[595] Secs. 401(a), 403(a), 403(b), 457(b).

[596] Sec. 401(k).

[597] Secs. 402(g) and 414(v).

[598] For this purpose members of a controlled group or affiliated service group are treated as a single employer.

[599] Sec. 402(g)(7).

employee's compensation.[600] Because employees generally do not receive compensation for years after they have terminated employment, contributions generally cannot be made for former employees. However, under a special rule, employer contributions to a section 403(b) plan can be made for up to five years after termination of employment.[601]

The limit described above on aggregate contributions to a qualified defined contribution plan applies to contributions for an employee to any defined contribution plans maintained by the same employer, defined generally to include any members of a controlled group (using an ownership standard of more than 50 percent, rather than at least 80 percent) or affiliated service group. Similarly, the limit on aggregate contributions to a section 403(b) plan applies to contributions for an employee to any section 403(b) plan maintained by the same employer, including any members of a controlled group or affiliated service group. However, contributions to a qualified defined contribution plan and to a section 403(b) plan maintained by the same employer are subject to separate limits unless the employee in the section 403(b) plan is in control of the employer maintaining the qualified defined contribution plan. This could occur, for example, if the employee in the section 403(b) plan owns a separate business that maintains a qualified defined contribution plan. In that case, a single limit applies to the contributions for the employee to the section 403(b) plan and the defined contribution plan. However, deferrals under a governmental section 457(b) plan are not taken into account in applying this limit.

In the case of a governmental section 457(b) plan, all contributions are subject to a single limit, generally for 2017, the lesser of (1) \$18,000 plus an additional \$6,000 catch-up contribution limit for employees at least age 50 and (2) the employee's compensation.[602] This limit is separate from the limit on elective deferrals to section 401(k) and section 403(b) plans. Thus, for example, if an employee participates in both a section 403(b) plan and a governmental section 457(b) plan of the same employer, the employee may contribute up to \$18,000 (plus \$6,000 catch-up contributions if at least age 50) to the section 403(b) plan and up to \$18,000 (plus \$6,000 catch-up contributions if at least age 50) to the section 457(b) plan. In addition, under a special rule, catch-up contributions may be made by an employee to a governmental section 457(b) for the last three years before attainment of normal retirement age. Additional contributions may be made up to the lesser of (1) two times the otherwise applicable dollar limit for the year (two times \$18,000 for 2017, or \$36,000) and (2) the employee's otherwise applicable limit for the year plus the amount by which the limit applicable to the employee for previous years exceeded the employee's deferrals for the previous years.[603] If a higher limit applies to an employee for a year under this special rule than under the general catch-up rule (\$6,000 for 2017), the general catch-up rule does not apply for the year.

[600] Sec. 415(c). Employee contributions to qualified defined benefit plans are also taken into account in applying this limit.

[601] Sec. 403(b)(3), permitting compensation received up to five years previously as compensation for the current year. In addition, under a special rule in section 415(c)(7), certain contribution amounts are permitted for church employees and foreign missionaries.

[602] Secs. 414(v) and 457(b)(2) and (e)(15).

[603] Sec. 457(b)(3).

Description of Proposal

The proposal applies a single aggregate limit to contributions for an employee in a governmental section 457(b) plan and elective deferrals for the same employee under a section 401(k) plan or a 403(b) plan of the same employer. Thus, the limit for governmental section 457(b) plans is coordinated with the limit for section 401(k) and 403(b) plans in the same manner as the limits are coordinated under present law for elective deferrals to section 401(k) and section 403(b) plans.

The proposal repeals the special rules allowing additional elective deferrals and catch-up contributions under section 403(b) plans and governmental section 457(b) plans. Thus, the same limits apply to elective deferrals and catch-up contributions under section 401(k) plans, section 403(b) plans and governmental section 457(b) plans.

The proposal repeals the special rule allowing employer contributions to section 403(b) plans for up to five years after termination of employment.[604]

The proposal also revises application of the limit on aggregate contributions to a qualified defined contribution plan or a section 403(b) plan (that is, the lesser of (1) $54,000 (for 2017) and (2) the employee's compensation). As revised, a single aggregate limit applies to contributions for an employee to any defined contribution plans, any section 403(b) plans, and any governmental section 457(b) plans maintained by the same employer, including any members of a controlled group or affiliated service group.[605]

Effective Date

The proposal is effective for plan years and taxable years beginning after December 31, 2017.

2. Application of 10-percent early withdrawal tax to governmental section 457(b) plans

Present Law

Tax-favored employer-sponsored retirement plans include a qualified retirement plan, a tax-sheltered annuity plan (referred to as a "section 403(b) plan"), and an eligible deferred compensation plan of a State or local government (referred to as a "governmental section 457(b) plan").[606] A simplified employee pension ("SEP") plan and SIMPLE IRA plan are also

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[604] The proposal does not repeal the special rule in section 415(c)(7), under which certain contribution amounts are permitted for church employees and foreign missionaries.

[605] As under present law, employee contributions to qualified defined benefit plans are also taken into account in applying this limit.

[606] Secs. 401(a), 403(a), 403(b), and 457(b).

tax-favored employer-sponsored retirement plans under which the employer makes contributions to an individual retirement arrangement ("IRA") established for each of its employees.[607]

In general, similar tax treatment applies to contributions to and distributions from these plans. Distributions are generally includible in income except to the extent attributable to after-tax contributions or qualified distributions from Roth accounts. In addition, unless an exception applies, a distribution from a qualified retirement plan, section 403(b) plan, or IRA (including a SEP or SIMPLE IRA) before age 59½ is subject to an additional tax (the "early withdrawal tax").[608] The early withdrawal tax is equal to 10 percent of the amount of the distribution that is includible in income (25 percent in the case of certain SIMPLE IRA distributions). The early withdrawal tax does not apply to distributions from governmental section 457(b) plans.

Description of Proposal

Under the proposal, unless an exception applies, the early withdrawal tax applies to a distribution from a governmental section 457(b) plan before age 59½ to the extent the distribution is includible in income.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Elimination of catch-up contributions for high-wage employees

Present Law

Account-based tax-favored employer-sponsored retirement plans include a qualified defined contribution plan, a tax-sheltered annuity plan (referred to as a section 403(b) plan), and an eligible deferred compensation plan of a State or local government (referred to as a governmental section 457(b) plan).[609] A simplified employee pension ("SEP") plan and SIMPLE IRA plan are also tax-favored employer-sponsored retirement plans under which the employer makes contributions to an individual retirement arrangement ("IRA") established for each of its employees.[610] For purposes of these plans, a self-employed individual is treated as an employee.[611]

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[607] Sec. 408(k) and (p).

[608] Sec. 72(t).

[609] Secs. 401(a), 403(a), 403(b), and 457(b).

[610] Sec. 408(k) and (p).

[611] Sec. 401(c)(1).

As discussed above, contributions to these plans for an employee are subject to an annual limit of the lesser of a specified dollar amount and the employee's compensation.[612] In the case of an employee age 50 or older, the specified dollar amount is increased by a certain amount (generally $6,000 for 2017), allowing the employee to make additional "catch-up" contributions for the year.[613]

Description of Proposal

Under the proposal, an employee may not make catch-up contributions for a year if the employee received wages of $500,000 or more for the preceding year.[614]

Effective Date

The proposal is effective for plan years and taxable years beginning after December 31, 2017.

[612] For this purposes, a self-employed individual's compensation is earned income, as defined in section 401(c)(2).

[613] Sec. 414(v). As discussed above, under present law, additional catch-up contributions may be permitted under a section 403(b) plan or governmental section 457(b) plan.

[614] Catch-up contributions for a year are not permitted by a self-employed individual with earned income of more than $500,000 for the preceding year.

TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

PRESENT LAW

The following discussion of present law provides an overview of general principles of taxation of cross-border activity as well as a detailed explanation of provisions in present law that are relevant to the proposals in Title IV of the bill.

A. General Overview of International Principles of Taxation

International law generally recognizes the right of each sovereign nation to prescribe rules to regulate conduct with a sufficient nexus to the sovereign nation. The nexus may be based on nationality of the actor, *i.e.*, a nexus between said conduct and a person (whether natural or juridical) with a connection to the sovereign nation, or it may be territorial, *i.e.*, a nexus between the conduct to be regulated and the territory where the conduct occurs.[615] For example, most legal systems respect limits on the extent to which their measures may be given extraterritorial effect. The broad acceptance of such norms extends to authority to regulate cross-border trade and economic dealings, including taxation.

The exercise of sovereign jurisdiction is usually based on either nationality of the person whose conduct is regulated or the territory in which the conduct or activity occurs. These concepts have been refined and, in varying combinations, adapted to form the principles for determining whether sufficient nexus with a jurisdiction exists to conclude that the jurisdiction may enforce its right to impose a tax. The elements of nexus and the nomenclature of the principles may differ based on the type of tax in question. Taxes are categorized as either direct taxes or indirect taxes. The former category generally refers to those taxes that are imposed directly on a person ("capitation tax"), property, or income from property and that cannot be shifted to another person by the taxpayer. In contrast, indirect taxes are taxes on consumption or production of goods or services, for which a taxpayer may shift responsibility to another person. Such taxes include sales or use taxes, value-added taxes, or customs duties.[616]

Although governments have imposed direct taxes on property and indirect taxes and duties on specific transactions since ancient times, the history of direct taxes in the form of an income tax is relatively recent.[617] When determining how to allocate the right to tax a particular

[615] American Law Institute, *Restatement (Third) of Foreign Relations Law of the United States*, secs. 402 and 403, (1987).

[616] Maria S. Cox, Fritz Neumark, et al., "Taxation" *Encyclopedia Britannica*, https://www.britannica.com/topic/taxation/Classes-of-taxes, accessed May 16, 2017. Whether a tax is considered a direct tax or indirect tax has varied over time, and no single definition is used. For a review of the significance of these terms in Federal tax history, see Alan O. Dixler, "Direct Taxes Under the Constitution: A Review of the Precedents," *Tax History Project, Tax Analysts*, available at http://www.taxhistory.org/thp/readings.nsf/ArtWeb/2B34C7FBDA41D9DA852573080067017?OpenDocument, accessed May 17, 2017.

[617] The earliest western income tax system is traceable to the British Tax Act of 1798, enacted in 1799 to raise funds needed to prosecute the Napoleonic Wars, and rescinded in 1816. See, A.M. Bardopoulos, *eCommerce*

item of income, most jurisdictions consider principles based on either source (territory or situs of the income) or residence (nationality of the taxpayer).[618] By contrast, when the authority to collect indirect taxes in the form of sales taxes or value added taxes is under consideration, jurisdictions analyze the taxing rights in terms of the origin principle or destination principle. The balance of this Part I.A describes the principles in more detail and how jurisdictions resolve claims of overlapping jurisdiction.

1. Origin and destination principles

Indirect taxes that are imposed based on the place where production of goods or services occur, irrespective of the location of the persons who own the means of production, and where the goods and services go after being produced, are examples of origin-based taxes. If, instead, authority to tax a transaction or service is dependent on the location of use or consumption of the goods or services, the tax system is an example of a destination-based tax. The most common form of a destination-based tax is the destination-based value-added tax ("VAT"). Over 160 countries have adopted a VAT,[619] which is generally a tax imposed and collected on the "value added" at every stage in the production and distribution of a good or service. Although there are several ways to compute the taxable base for a VAT, the amount of value added can generally be thought of as the difference between the value of sales (outputs) and purchases (inputs) of a business.[620] The United States does not have a VAT, nor is there a Federal sales or use tax.

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and the Effects of Technology on Taxation, Law, Governance and Technology Series 22, DOI 10.1007/978-3-319-15449-7_2, (Springer 2015), at Section 2.2. "History of Tax," pp. 23-24. See also, http://www.parliament.uk/about/living-heritage/transformingsociety/private-lives/taxation/overview/incometax/.

[618] Reuven Avi-Yonah, "International Tax as International Law," 57 *Tax Law Review* 483 (2003-2004).

[619] Alan Schenk, Victor Thuronyi, and Wei Cui, *Value Added Tax: A Comparative Approach*, Cambridge University Press, 2015. Consistent with the OECD *International VAT/GST Guidelines*, *supra,* the term VAT is used to refer to all broad-based final consumption taxes, regardless of the acronym used to identify. Thus, many countries that denominate their national consumption tax as a GST (general sales tax) are included in the estimate of the number of countries with a VAT.

[620] Nearly all countries use the credit-invoice method of calculating value added to determine VAT liability. Under the credit-invoice method, a tax is imposed on the seller for all of its sales. The tax is calculated by applying the tax rate to the sales price of the good or service, and the amount of tax is generally disclosed on the sales invoice. A business credit is provided for all VAT levied on purchases of taxable goods and services (*i.e.*, "inputs") used in the seller's business. The ultimate consumer (*i.e.*, a non-business purchaser), however, does not receive a credit with respect to his or her purchases. The VAT credit for inputs prevents the imposition of multiple layers of tax with respect to the total final purchase price (*i.e.*, a "cascading" of the VAT). As a result, the net tax paid at a particular stage of production or distribution is based on the value added by that taxpayer at that stage of production or distribution. In theory, the total amount of tax paid with respect to a good or service from all levels of production and distribution should equal the sales price of the good or service to the ultimate consumer multiplied by the VAT rate.

In order to receive an input credit with respect to any purchase, a business purchaser is generally required to possess an invoice from a seller that contains the name of the purchaser and indicates the amount of tax collected by the seller on the sale of the input to the purchaser. At the end of a reporting period, a taxpayer may calculate its tax liability by subtracting the cumulative amount of tax stated on its purchase invoices from the cumulative amount of tax stated on its sales invoices.

However, the majority of the States have enacted sales or use taxes, including both origin-based taxes and destination-based taxes.[621]

With respect to cross-border transactions, the OECD has recommended that the destination principle be adopted for all indirect taxes, in part to conform to the treatment of such transactions for purposes of customs duties. The OECD defines the destination principle as "the principle whereby, for consumption tax purposes, internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption."[622] A jurisdiction may determine the place of use or consumption by adopting the convention that the place of business or residence of a customer is the place of consumption. Use of such proxies are needed to determine the location of businesses that are juridical entities, which are more able than natural persons to move the location of use of goods, services or intangibles in response to imposition of tax.

2. Source and residence principles

Exercise of taxing authority based on a person's residence may be based on status as a national, resident, or domiciliary of a jurisdiction and may reach worldwide activities of such persons. As such, it is the broadest assertion of taxing authority. For individuals, the test for residence may depend upon nationality, or a physical presence test, or some combination of the two. For all other persons, determining residency may require more complex consideration of the level of activities within a jurisdiction, management, control or place of incorporation. Such rules generally reflect a policy decision about the requisite level of activity within, or contact with, a jurisdiction by a person that is sufficient to warrant assertion of taxing jurisdiction.

Source-based exercise of taxing authority taxes income from activities that occur, or property that is located, within the territory of the taxing jurisdiction. If a person conducts business or owns property in a jurisdiction, or if a transaction occurs in whole or in part in a jurisdiction, the resulting taxation may require allocation and apportionment of expenses attributable to the activity in order to ensure that only the portion of profits that have the required nexus with the territory are subject to tax. Most jurisdictions, including the United States, have rules for determining the source of items of income and expense in a broad range of categories such as compensation for services, dividends, interest, royalties and gains.

Regardless of which of these two bases of taxing authority is chosen by a jurisdiction, a jurisdiction's determination of whether a transaction, activity or person is subject to tax requires that the jurisdiction establish the limits on its assertion of authority to tax.

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[621] EY, *Worldwide VAT, GST and Sales Tax Guide 2015*, p. 1021, available at http://www.ey.com/Publication/vwLUAssets/Worldwide-VAT-GST-and-sales-tax-guide-2015/$FILE/Worldwide%20VAT,%20GST%20and%20Sales%20Tax%20Guide%202015.pdf.

[622] See, OECD, "Recommendation of the Council on the application of value added tax/goods and services tax to the international trade in services and intangibles as approved on September 27, 2016," [C(2016)120], appendix, page 3, reproduced in the appendix, OECD, *International VAT/GST Guidelines*, OECD Publishing, 2017.

3. Resolving overlapping or conflicting jurisdiction to tax

Countries have developed norms about what constitutes a reasonable regulatory action by a sovereign state that will be respected by other sovereign states. Consensus on what constitutes a reasonable limit on the extent of one state's jurisdiction helps to minimize the risk of conflicts arising as a result of extraterritorial action by a state or overlapping exercise of authority by states. Mechanisms to eliminate double taxation have developed to address those situations in which the source and residency determinations of the respective jurisdictions result in duplicative assertion of taxing authority. For example, asymmetry between different standards adopted in two countries for determining residency of persons, source of income, or other basis for taxation may result in income that is subject to taxation in both jurisdictions.

When the rules of two or more countries overlap, potential double taxation is usually mitigated by operation of bilateral tax treaties or by legislative measures permitting credit for taxes paid to another jurisdiction. The United States is a partner in numerous bilateral agreements that have as their objective the avoidance of international double taxation and the prevention of tax avoidance and evasion. Another related objective of U.S. tax treaties is the removal of the barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from, that jurisdiction are minimal. The United States Model Income Tax Convention ("U.S. Model Treaty of 2016") with an accompanying Preamble by the Department of Treasury, reflects the most recent comprehensive statement of U.S. negotiating position with respect to tax treaties.[623] Bilateral agreements are also used to permit limited mutual administrative assistance between jurisdictions.[624]

In addition to entering into bilateral treaties, countries have worked in multilateral organizations to develop common principles to alleviate double taxation. Those principles are generally reflected in the provisions of the Model Tax Convention on Income and on Capital of the Organization for Economic Cooperation and Development (the "OECD Model treaty"),[625] a

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[623] The current U.S. Model treaty was published February 17, 2016, and is available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf; the Preamble is available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Preamble-US%20Model-2016.pdf. The U.S. Model treaty is updated periodically to reflect developments in the negotiating position of the United States. Such changes include provisions that were successfully included in bilateral treaties concluded by the United States, as well as new proposed measures not yet included in a bilateral agreement.

[624] Although U.S. courts extend comity to foreign judgments in some instances, they are not required to recognize or assist in enforcement of foreign judgments for collection of taxes, consistent with the common law "revenue rule" in *Holman v. Johnson*, 1 Cowp. 341, 98 Eng. Rep. 1120 (K.B.1775). American Law Institute, *Restatement (Third) of Foreign Relations Law of the United States*, sec. 483, (1987). The rule retains vitality in U.S. case law. *Pasquantino v. United States,* 544 U.S. 349; 125 S. Ct. 1766; 161 L. Ed. 2d 619 (2005) (a conviction for criminal wire fraud arising from an intent to defraud Canadian tax authorities was found not to conflict "with any well-established revenue rule principle[,]" and thus was not in derogation of the revenue rule). To the extent it is abrogated, it is done so in bilateral treaties, to ensure reciprocity. At present, the United States has such agreements in force with five jurisdictions: Canada; Denmark; France; Netherlands; and Sweden.

[625] OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing, 2014, available at http://dx.doi.org/10.1787//mtc_cond-2014-en. The multinational organization was

precursor of which was first developed by a predecessor organization in 1958, which in turn has antecedents from work by the League of Nations in the 1920s.[626] As a consensus document, the OECD Model treaty is intended to serve as a model for countries to use in negotiating a bilateral treaty that would settle issues of double taxation as well as to avoid inappropriate double nontaxation. The provisions have developed over time as practice with actual bilateral treaties leads to unexpected results and new issues are raised by parties to the treaties.[627]

4. International principles as applied in the U.S. system

Present law combines taxation of all U.S. persons on their worldwide income, whether derived in the United States or abroad, with limited deferral of taxation of income earned by foreign subsidiaries of U.S. companies and source-based taxation of the U.S.-source income of nonresident aliens and foreign entities. Under this system (sometimes described as the U.S. hybrid system), the application of the Code differs depending on whether income arises from outbound investment or inbound investment. Outbound investment refers to the foreign activities of U.S. persons, while inbound investment is investment by foreign persons in U.S. assets or activities, although certain rules are common to both inbound and outbound activities.

B. Principles Common to Inbound and Outbound Taxation

Although the U.S. tax rules differ depending on whether the activity in question is inbound or outbound, there are certain concepts that apply to both inbound and outbound investment. Such areas include the transfer pricing rules, entity classification, the rules for determination of source, and whether a corporation is foreign or domestic.

1. Residence

U.S. persons are subject to tax on their worldwide income. The Code defines U.S. person to include all U.S. citizens and residents as well as domestic entities such as partnerships, corporations, estates and certain trusts.[628] The term "resident" is defined only with respect to natural persons. Noncitizens who are lawfully admitted as permanent residents of the United States in accordance with immigration laws (colloquially referred to as green card holders) are

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first established in 1961 by the United States, Canada and 18 European countries, dedicated to global development, and has since expanded to 35 members.

[626] "Report by the Experts on Double Taxation," League of Nation Document E.F.S. 73\F19 (1923), a report commissioned by the League at its second assembly. See also, Lara Friedlander and Scott Wilkie, "Policy Forum: The History of Tax Treaty Provisions--And Why It Is Important to Know About It," 54 *Canadian Tax Journal* No. 4 (2006).

[627] For example, the OECD initiated a multi-year study on base-erosion and profit shifting in response to concerns of multiple members. For an overview of that project, see Joint Committee on Taxation, *Background, Summary, and Implications of the OECD/G20 Base Erosion and Profit Shifting Project* (JCX-139-15), November 30, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

[628] Sec. 7701(a)(30).

treated as residents for tax purposes. In addition, noncitizens who meet a substantial presence test and are not otherwise exempt from U.S. taxation are also taxable as U.S. residents.[629]

For legal entities, the Code determines whether an entity is subject to U.S. taxation on its worldwide income on the basis of its place of organization. For purposes of U.S. tax law, a corporation or partnership is treated as domestic if it is organized or created under the laws of the United States or of any State, unless, in the case of a partnership, the Secretary prescribes otherwise by regulation.[630] All other partnerships and corporations (that is, those organized under the laws of foreign countries) are treated as foreign.[631] In contrast, place of organization is not determinative of residence under taxing jurisdictions that use factors such as situs, management and control to determine residence. As a result, legal entities may have more than one tax residence, or, in some case, no residence.[632] Only domestic corporations are subject to U.S. tax on a worldwide basis. Foreign corporations are taxed only on income that has a sufficient connection with the United States.

Tax benefits otherwise available to a domestic corporation that migrates its tax home from the United States to foreign jurisdiction may be denied to such corporation, in which case it continues to be treated as a domestic corporation for ten years following such migration.[633] These sanctions generally apply to a transaction in which, pursuant to a plan or a series of related transactions: (1) a domestic corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the domestic corporation hold (by reason of the stock they had held in the domestic corporation) at least 60 percent but less than 80 percent (by vote or value) of the stock of the foreign-incorporated entity after the transaction (this stock often being referred to as "stock held by reason of"); and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (that is, the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group.[634]

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[629] Sec. 7701(b).

[630] Sec. 7701(a)(4).

[631] Secs. 7701(a)(5) and 7701(a)(9). Entities organized in a possession or territory of the United States are not considered to have been organized under the laws of the United States.

[632] "The notion of corporate residence is an important touchstone of taxation, however, in many foreign income tax systems[,]" with the result that the bilateral treaties are often relied upon to resolve conflicting claims of taxing jurisdiction. Joseph Isenbergh, Vol. 1 *U.S. Taxation of Foreign Persons and Foreign Income*, Para. 7.1 (Fourth Ed. 2016).

[633] Sec. 7874.

[634] Section 7874(a). In addition, an excise tax may be imposed on certain stock compensation of executives of companies that undertake inversion transactions. Sec. 4985.

The Treasury Department and the IRS have promulgated detailed guidance, through both regulations and several notices, addressing these requirements under section 7874 since the section was enacted in 2004,[635] and have sought to expand the reach of the section or reduce the tax benefits of inversion transactions. For example, Notice 2014-52 announced Treasury's and the IRS's intention to issue regulations and took a two-pronged approached. First, it addressed the treatment of cross-border combination transactions themselves. Second, it addressed post-transaction steps that taxpayers may undertake with respect to US-owned foreign subsidiaries making it more difficult to access foreign earnings without incurring added U.S. tax. On November 19, 2015, Treasury and the IRS issued Notice 2015-79, which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance issued in Notice 2014-52. In 2016, Treasury and the IRS issued proposed and temporary regulations that incorporate the rules previously announced in Notice 2014-52 and Notice 2015-79 and a new multiple domestic entity acquisition rule.[636]

In early 2017, Treasury issued final and temporary regulations[637] that adopt, with few changes, the 2016 temporary and proposed regulations.

2. Entity classification

Certain entities are eligible to elect their classification for Federal tax purposes under the "check-the-box" regulations adopted in 1997.[638] Those regulations simplified the entity classification process for both taxpayers and the IRS by making the entity classification of unincorporated entities explicitly elective in most instances.[639] The eligibility to elect and the

[635] Notice 2015-79, 2015 I.R.B. LEXIS 583 (Nov. 19, 2015), which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance issued in Notice 2014-52. On April 4, 2016, Treasury and the IRS issued proposed and temporary regulations (T.D. 9761) that incorporate the rules previously announced in Notice 2014-52 and Notice 2015-79 and a new multiple domestic entity acquisition rule. On January 13, 2017, Treasury and the IRS issued final and temporary regulations under section 7874 (T.D. 9812), which adopt, with few changes, prior temporary and proposed regulations, which identify certain stock of an acquiring foreign corporation that is disregarded in calculating the ownership of the foreign corporation for purposes of section 7874.

[636] T.D. 9761, April 4, 2016. But see, *Chamber of Commerce v Internal Revenue Service*, Cause No 1:16-CV-944-LY (W.D. Tex. Sept. 29, 2017), granting summary judgment to plaintiff in challenge to temporary regulations based on lack of compliance with Administrative Procedure Requirements.

[637] T.D. 9812, January 13, 2017.

[638] Treas. Reg. sec. 301.7701-1, *et seq*.

[639] The check-the-box regulations replaced Treas. Reg. sec. 301.7701-2, as in effect prior to 1997, under which the classification of unincorporated entities for Federal tax purposes was determined on the basis of a four characteristics indicative of status as a corporation: continuity of life, centralization of management, limited liability, and free transferability of interests. An entity that possessed three or more of these characteristics was treated as a corporation; if it possessed two or fewer, then it was treated as a partnership. Thus, to achieve characterization as a partnership under this system, taxpayers needed to arrange the governing instruments of an entity in such a way as to eliminate two of these corporate characteristics. The advent and proliferation of limited liability companies ("LLCs") under State laws allowed business owners to create customized entities that possessed

breadth of an entity's choices depend upon whether it is a "per se corporation" and its number of beneficial owners. Foreign as well as domestic entities may make the election. As a result, it is possible for an entity that operates across countries to be treated as a hybrid entity. A hybrid entity is one which is treated as a flow-through or disregarded entity for U.S. tax purposes but as a corporation for foreign tax purposes. For "reverse hybrid entities," the opposite is true. The election can affect the determination of the source of the income, availability of tax credits, and other tax attributes.

3. Source of income rules

The rules for determining the source of certain types of income are specified in the Code and described briefly below. Various factors determine the source of income for U.S. tax purposes, including the status or nationality of the payor, the status or nationality of the recipient, the location of the recipient's activities that generate the income, and the location of the assets that generate the income. To the extent that the source of income is not specified by statute, the Treasury Secretary may promulgate regulations that explain the appropriate treatment. However, many items of income are not explicitly addressed by either the Code or Treasury regulations, sometimes resulting in nontaxation of the income. On several occasions, courts have determined the source of such items by applying the rule for the type of income to which the disputed income is most closely analogous, based on all facts and circumstances.[640]

Interest

Interest is derived from U.S. sources if it is paid by the United States or any agency or instrumentality thereof, a State or any political subdivision thereof, or the District of Columbia. Interest is also from U.S. sources if it is paid by a resident or a domestic corporation on a bond, note, or other interest-bearing obligation.[641] Special rules apply to treat as foreign-source certain amounts paid on deposits with foreign commercial banking branches of U.S. corporations or partnerships and certain other amounts paid by foreign branches of domestic financial institutions.[642] Interest paid by the U.S. branch of a foreign corporation is also treated as U.S.-source income.[643]

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a critical common feature—limited liability for investors—as well as other corporate characteristics the owners found desirable. As a consequence, classification was effectively elective for well-advised taxpayers.

[640] See, *e.g.*, *Hunt v. Commissioner*, 90 T.C. 1289 (1988).

[641] Sec. 861(a)(1); Treas. Reg. sec. 1.861-2(a)(1).

[642] Secs. 861(a)(1) and 862(a)(1). For purposes of certain reporting and withholding obligations the source rule in section 861(a)(1)(B) does not apply to interest paid by the foreign branch of a domestic financial institution. This results in the payment being treated as a withholdable payment. Sec. 1473(1)(C).

[643] Sec. 884(f)(1).

Dividends

Dividend income is generally sourced by reference to the payor's place of incorporation.[644] Thus, dividends paid by a domestic corporation are generally treated as entirely U.S.-source income. Similarly, dividends paid by a foreign corporation are generally treated as entirely foreign-source income. Under a special rule, dividends from certain foreign corporations that conduct U.S. businesses are treated in part as U.S.-source income.[645]

Rents and royalties

Rental income is sourced by reference to the location or place of use of the leased property.[646] The nationality or the country of residence of the lessor or lessee does not affect the source of rental income. Rental income from property located or used in the United States (or from any interest in such property) is U.S.-source income, regardless of whether the property is real or personal, intangible or tangible.

Royalties are sourced in the place of use of (or the place of privilege to use) the property for which the royalties are paid.[647] This source rule applies to royalties for the use of either tangible or intangible property, including patents, copyrights, secret processes, formulas, goodwill, trademarks, trade names, and franchises.

Income from sales of personal property

Subject to significant exceptions, income from the sale of personal property is sourced on the basis of the residence of the seller.[648] For this purpose, special definitions of the terms "U.S. resident" and "nonresident" are provided. A nonresident is defined as any person who is not a U.S. resident,[649] while the term "U.S. resident" comprises any juridical entity which is a U.S. person, all U.S. citizens, as well as any individual who is a U.S. resident without a tax home in a foreign country or a nonresident alien with a tax home in the United States.[650] As a result, nonresident includes any foreign corporation.[651]

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644 Secs. 861(a)(2), 862(a)(2).

645 Sec. 861(a)(2)(B).

646 Sec. 861(a)(4).

647 *Ibid.*

648 Sec. 865(a).

649 Sec. 865(g)(1)(B).

650 Sec. 865(g)(1)(A).

651 Sec. 865(g).

Several special rules apply. For example, income from the sale of inventory property is generally sourced to the place of sale, which is determined by where title to the property passes.[652] However, if the sale is by a nonresident and is attributable to an office or other fixed place of business in the United States, the sale is treated as income from U.S. sources without regard to the place of sale, unless it is sold for use, disposition, or consumption outside the United States and a foreign office materially participates in the sale.[653] Income from the sale of inventory property that a taxpayer produces (in whole or in part) in the United States and sells outside the United States, or that a taxpayer produces (in whole or in part) outside the United States and sells in the United States, is treated as partly U.S.-source and partly foreign-source.[654]

In determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS has taken the position that to the extent that there is unrealized gain attributable to partnership assets that are effectively connected with the U.S. business, the foreign person's gain or loss from the sale or exchange of a partnership interest is effectively connected gain or loss to the extent of the partner's distributive share of such unrealized gain or loss, and not capital gain or loss. Similarly, to the extent that the partner's distributive share of unrealized gain is attributable to a permanent establishment of the partnership under an applicable treaty provision, it may be subject to U.S. tax under a treaty.[655]

Gain on the sale of depreciable property is divided between U.S.-source and foreign-source in the same ratio that the depreciation was previously deductible for U.S. tax purposes.[656] Payments received on sales of intangible property are sourced in the same manner as royalties to the extent the payments are contingent on the productivity, use, or disposition of the intangible property.[657]

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[652] Secs. 865(b), 861(a)(6), 862(a)(6); Treas. Reg. sec. 1.861-7(c).

[653] Sec. 865(e)(2).

[654] Sec. 863(b). A taxpayer may elect one of three methods for allocating and apportioning income as U.S.- or foreign-source: (1) the 50-50 method under which 50 percent of the income from the sale of inventory property in such a situation is attributable to the production activities and 50 percent to the sales activities, with the income sourced based on the location of those activities; (2) independent factory price ("IFP") method under which, in certain circumstances, an IFP may be established by the taxpayer to determine income from production activities; (3) the books and records method under which, with advance permission, the taxpayer may use books of account to detail the allocation of receipts and expenditures between production and sales activities. Treas. Reg. sec. 1.863-3(b), (c). If production activity occurs only within the United States, or only within foreign countries, then all income is sourced to where the production activity occurs; when production activities occur in both the United States and one or more foreign countries, the income attributable to production activities must be split between U.S. and foreign sources. Treas. Reg. sec. 1.863-3(c)(1). The sales activity is generally sourced based on where title to the property passes. Treas. Reg. secs. 1.863-3(c)(2), 1.861-7(c).

[655] Rev. Rul. 91-32, 1991-1 C.B. 107. But see, Grecian Magnesite Mining, Industrial & Shipping Co. SA v Commissioner, 149 T.C. No. 3 (2017).

[656] Sec. 865(c).

[657] Sec. 865(d).

Personal services income

Compensation for labor or personal services is generally sourced to the place-of-performance. Thus, compensation for labor or personal services performed in the United States generally is treated as U.S.-source income, subject to an exception for amounts that meet certain *de minimis* criteria.[658] Compensation for services performed both within and without the United States is allocated between U.S.-and foreign-source.[659]

Insurance income

Underwriting income from issuing insurance or annuity contracts generally is treated as U.S.-source income if the contract involves property in, liability arising out of an activity in, or the lives or health of residents of, the United States.[660]

Transportation income

Sources rules generally provide that income from furnishing transportation that both begins and ends in the United States is U.S.-source income,[661] and 50-percent of income attributable to transportation that either begins or the ends in the United States is treated as U.S.-source income. However, to the extent that the operator of a shipping or cruise line is foreign, its ownership structure and the maritime law[662] applicable for determining what constitutes international shipping as well as specific income tax provisions combine to create an industry-specific departure from the rules generally applicable.[663]

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[658] Sec. 861(a)(3). Gross income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship is generally treated as foreign-source income.

[659] Treas. Reg. sec. 1.861-4(b).

[660] Sec. 861(a)(7).

[661] Sec. 863(c).

[662] U.S. law on navigation is codified in U.S. Code at title 33, and is consistent with the body of international maritime law. The normative principles of international maritime law for determining the maritime zones and territorial sovereignty over seas are embodied in the United Nations Convention on the Law of the Sea, first opened for signature in 1982. Since 1983, the Executive Branch has agreed that the treaty is generally consistent with existing international norms of the law of the sea and that the United States would act in conformity to the principles of the treaty other than those portions regarding deep seabed exploitation, even in the absence of ratification of the treaty.

[663] Due to the regulatory framework for aviation, an international flight must either originate or conclude in the country of residence of the airline's owner, where income tax for the international flight is assessed. In contrast to international shipping, international aviation cannot be carried out using flags-of-convenience. Thus, although tax law treats shipping and aviation similarly, the differences between the two industries and the applicable regulatory regimes produce different tax outcomes. Full territorial sovereignty applies within 12 nautical miles of one's coast; the contiguous waters beyond 12 nautical miles but up to 24 nautical miles are subject to some regulation. Within 200 nautical miles, a country may assert an economic zone for exploitation of living marine resources and some

Income from space or ocean activities or international communications

In the case of a foreign person, generally no income from a space or ocean activity or from international communications is treated as U.S.-source income.[664] With respect to the latter, an exception is provided if the foreign person maintains an office or other fixed place of business in the United States, in which case the international communications income attributable to such fixed place of business is treated as U.S.-source income.[665] For U.S. persons, all income from space or ocean activities and 50 percent of income from international communications is treated as U.S.-source income.

Amounts received with respect to guarantees of indebtedness

Amounts received, directly or indirectly, from a noncorporate resident or from a domestic corporation for the provision of a guarantee of indebtedness of such person are income from U.S. sources.[666] This includes payments that are made indirectly for the provision of a guarantee. For example, U.S.-source income under this rule includes a guarantee fee paid by a foreign bank to a foreign corporation for the foreign corporation's guarantee of indebtedness owed to the bank by the foreign corporation's domestic subsidiary, where the cost of the guarantee fee is passed on to the domestic subsidiary through, for instance, additional interest charged on the indebtedness. In this situation, the domestic subsidiary has paid the guarantee fee as an economic matter through higher interest costs, and the additional interest payments made by the subsidiary are treated as indirect payments of the guarantee fee and, therefore, as income from U.S. sources.

Such U.S.-source income also includes amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of indebtedness of that foreign person if the payments received are connected with income of such person that is effectively connected with the conduct of a U.S. trade or business. Amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of that person's debt, are treated as foreign-source income if they are not from sources within the United States under section 861(a)(9).

minerals. Beyond 200 nautical miles are the "high seas" in which no sovereign state may assert exclusive jurisdiction.

[664] Sec. 863(d).

[665] Sec. 863(e).

[666] Sec. 861(a)(9). This provision effects a legislative override of the opinion in *Container Corp. v. Commissioner*, 134 T.C. 122 (February 17, 2010), aff'd 2011 WL1664358, 107 A.F.T.R.2d 2011-1831 (5th Cir. May 2, 2011), in which the Tax Court held that fees paid by a domestic corporation to its foreign parent with respect to guarantees issued by the parent for the debts of the domestic corporation were more closely analogous to compensation for services than to interest, and determined that the source of the fees should be determined by reference to the residence of the foreign parent-guarantor. As a result, the income was treated as income from foreign sources.

4. Intercompany transfers

Transfer pricing

A basic U.S. tax principle applicable in dividing profits from transactions between related taxpayers is that the amount of profit allocated to each related taxpayer must be measured by reference to the amount of profit that a similarly situated taxpayer would realize in similar transactions with unrelated parties. The transfer pricing rules of section 482 and the accompanying Treasury regulations are intended to preserve the U.S. tax base by ensuring that taxpayers do not shift income properly attributable to the United States to a related foreign company through pricing that does not reflect an arm's-length result.[667] Similarly, the domestic laws of most U.S. trading partners include rules to limit income shifting through transfer pricing. The arm's-length standard is difficult to administer in situations in which no unrelated party market prices exist for transactions between related parties. When a foreign person with U.S. activities has transactions with related U.S. taxpayers, the amount of income attributable to U.S. activities is determined in part by the same transfer pricing rules of section 482 that apply when U.S. persons with foreign activities transact with related foreign taxpayers.

Section 482 authorizes the Secretary of the Treasury to allocate income, deductions, credits, or allowances among related business entities[668] when necessary to clearly reflect income or otherwise prevent tax avoidance, and comprehensive Treasury regulations under that section adopt the arm's-length standard as the method for determining whether allocations are appropriate.[669] The regulations generally attempt to identify the respective amounts of taxable income of the related parties that would have resulted if the parties had been unrelated parties dealing at arm's length. For income from intangible property, section 482 provides "in the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible." By requiring inclusion in income of amounts commensurate with the income attributable to the intangible, Congress was responding to concerns regarding the effectiveness of the arm's-length standard with respect to intangible property—including, in particular, high-profit-potential intangibles.[670]

[667] For a detailed description of the U.S. transfer pricing rules, see Joint Committee on Taxation, *Present Law and Background Related to Possible Income Shifting and Transfer Pricing* (JCX-37-10), July 20, 2010, pp. 18-50.

[668] The term "related" as used herein refers to relationships described in section 482, which refers to "two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests."

[669] Section 1059A buttresses section 482 by limiting the extent to which costs used to determine custom valuation can also be used to determine basis in property imported from a related party. A taxpayer that imports property from a related party may not assign a value to the property for cost purposes that exceeds its customs value.

[670] H.R. Rep. No. 99-426, p. 423.

Gain recognition on outbound transfers

If a transfer of intangible property to a foreign affiliate occurs in connection with certain corporate transactions, nonrecognition rules that may otherwise apply are suspended. The transferor of intangible property must recognize gain from the transfer as though he had sold the intangible (regardless of the stage of development of the intangible property) in exchange for payments contingent on the use, productivity or disposition of the transferred property in amounts that would have been received either annually over the useful life of the property or upon disposition of the property after the transfer.[671] The appropriate amounts of those imputed payments are determined using transfer-pricing principles. Final regulations issued in 2016 eliminate an exception under temporary regulations that permitted nonrecognition of gain from outbound transfers of foreign goodwill and going concern value. However, the Secretary announced that reinstatement of an exception for active trade or business is under consideration for cases with little potential for abuse and administrative difficulties.[672]

C. U.S. Tax Rules Applicable to Nonresident Aliens and Foreign Corporations (Inbound)

Nonresident aliens and foreign corporations are generally subject to U.S. tax only on their U.S.-source income. Thus, the source and type of income received by a foreign person generally determines whether there is any U.S. income tax liability and the mechanism by which it is taxed. The U.S. tax rules for U.S. activities of foreign taxpayers apply differently to two broad types of income: U.S.-source income that is "fixed or determinable annual or periodical gains, profits, and income" ("FDAP income") or income that is "effectively connected with the conduct of a trade or business within the United States" ("ECI"). FDAP income generally is subject to a 30-percent gross-basis tax withheld at its source, while ECI is generally subject to the same U.S. tax rules that apply to business income derived by U.S. persons. That is, deductions are permitted in determining taxable ECI, which is then taxed at the same rates applicable to U.S. persons. Much FDAP income and similar income is, however, exempt from tax or is subject to a reduced rate of tax under the Code[673] or a bilateral income tax treaty.[674]

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[671] Sec. 367(d).

[672] See, T.D. 9803, 81 F.R. 91012 (December 17, 2016). Treas. Reg. sec. 1.367(d)-1(b) now provides that the rules of section 367(d) apply to transfers of intangible property as defined under Treas. Sec. 1.367(a)-1(d)(5) after September 14, 2015, and to any transfers occurring before that date resulting from entity classification elections filed on or after September 15, 2015. Noting that commenters on the regulations had cited legislative history that contemplated active business exceptions, Treasury announced the reconsideration of the rule. U.S. Treasury Department, *Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, Executive Order 13789* October 2, 2017, TNT Doc 2017-72131. The relevant legislative history is found at in H.R. Rep. No. 98-432, 98th Cong., 2d Sess. 1318-1320 (March 5, 1984) and Conference Report, H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 951-957 (June 23, 1984).

[673] *E.g.*, the portfolio interest exception in section 871(h) (discussed below).

[674] Because each treaty reflects considerations unique to the relationship between the two treaty countries, treaty withholding tax rates on each category of income are not uniform across treaties.

1. Gross-basis taxation of U.S.-source income

Non-business income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30 percent, which is collected by withholding at the source of the payment. As explained below, the categories of income subject to the 30-percent tax and the categories for which withholding is required are generally coextensive, with the result that determining the withholding tax liability determines the substantive liability.

The income of non-resident aliens or foreign corporations that is subject to tax at a rate of 30-percent includes FDAP income that is not effectively connected with the conduct of a U.S. trade or business.[675] The items enumerated in defining FDAP income are illustrative; the common characteristic of types of FDAP income is that taxes with respect to the income may be readily computed and collected at the source, in contrast to the administrative difficulty involved in determining the seller's basis and resulting gain from sales of property.[676] The words "annual or periodical" are "merely generally descriptive" of the payments that could be within the purview of the statute and do not preclude application of the withholding tax to one-time, lump sum payments to nonresident aliens.[677]

With respect to income from shipping, the gross basis tax potentially applicable is four percent,[678] unless the income is effectively connected with a U.S. trade or business, and thus subject to the graduated rates, as determined under rules specific to U.S.-source gross transportation income rather than the more broadly applicable rules defining effectively connected income in section 864(c). Even if the income is within the purview of those special rules, it may nevertheless be exempt if the income is derived from the international operation of a ship or aircraft by a foreign entity organized in a jurisdiction which provides a reciprocal exemption to U.S. entities.[679]

<u>Types of FDAP income</u>

FDAP income encompasses a broad range of types of gross income, but has limited application to gains on sales of property, including market discount on bonds and option

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[675] Secs. 871(a), 881. If the FDAP income is also ECI, it is taxed on a net basis, at graduated rates.

[676] *Commissioner v. Wodehouse,* 337 U.S. 369, 388-89 (1949). After reviewing legislative history of the Revenue Act of 1936, the Supreme Court noted that Congress expressly intended to limit taxes on nonresident aliens to taxes that could be readily collectible, *i.e.*, subject to withholding, in response to "a theoretical system impractical of administration in a great number of cases. H.R. Rep. No. 2475, 74th Cong., 2d Sess. 9-10 (1936)." In doing so, the Court rejected P.G. Wodehouse's arguments that an advance royalty payment was not within the purview of the statutory definition of FDAP income.

[677] *Commissioner v. Wodehouse,* 337 U.S. 369, 393 (1949).

[678] Sec. 887.

[679] Sec. 883(a)(1). In addition, to the extent provided in regulations, income from shipping and aviation is not subject to the four-percent gross basis tax if the income is of a type that is not subject to the reciprocal exemption for net basis taxation. See sec. 887(b)(1). Comparable rules under section 872(b)(1) apply to income of nonresident alien individuals from shipping operations.

premiums.[680] Capital gains received by nonresident aliens present in the United States for fewer than 183 days are generally treated as foreign source and are thus not subject to U.S. tax, unless the gains are effectively connected with a U.S. trade or business; capital gains received by nonresident aliens present in the United States for 183 days or more[681] that are treated as income from U.S. sources are subject to gross-basis taxation.[682] In contrast, U.S-source gains from the sale or exchange of intangibles are subject to tax and withholding if they are contingent upon the productivity of the property sold and are not effectively connected with a U.S. trade or business.[683]

Interest on bank deposits may qualify for exemption on two grounds, depending on where the underlying principal is held on deposit. Interest paid with respect to deposits with domestic banks and savings and loan associations, and certain amounts held by insurance companies, are U.S.-source income but are not subject to the U.S. tax when paid to a foreign person, unless the interest is effectively connected with a U.S. trade or business of the recipient.[684] Interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not treated as U.S.-source income and is thus exempt from U.S. tax (regardless of whether the recipient is engaged in a U.S. trade or business).[685] Similarly, interest and original issue discount on certain short-term obligations is also exempt from U.S. tax when paid to a foreign person.[686] Additionally, there is generally no information reporting required with respect to payments of such amounts.[687]

Although FDAP income includes U.S.-source portfolio interest, such interest is specifically exempt from the 30-percent gross-basis tax. Portfolio interest is any interest

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[680] Although technically insurance premiums paid to a foreign insurer or reinsurer are FDAP income, they are exempt from withholding under Treas. Reg. sec. 1.1441-2(a)(7) if the insurance contract is subject to the excise tax under section 4371. Treas. Reg. secs. 1.1441-2(b)(1)(i) and 1.1441-2(b)(2).

[681] For purposes of this rule, whether a person is considered a resident in the United States is determined by application of the rules under section 7701(b).

[682] Sec. 871(a)(2). In addition, certain capital gains from sales of U.S. real property interests are subject to tax as effectively connected income (or in some instances as dividend income) under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA").

[683] Secs. 871(a)(1)(D), 881(a)(4).

[684] Secs. 871(i)(2)(A), 881(d); Treas. Reg. sec. 1.1441-1(b)(4)(ii).

[685] Sec. 861(a)(1)(B); Treas. Reg. sec. 1.1441-1(b)(4)(iii).

[686] Secs. 871(g)(1)(B), 881(a)(3); Treas. Reg. sec. 1.1441-1(b)(4)(iv).

[687] Treas. Reg. sec. 1.1461-1(c)(2)(ii)(A), (B). Regulations require a bank to report interest if the recipient is a nonresident alien who resides in a country with which the United States has a satisfactory exchange of information program under a bilateral agreement and the deposit is maintained at an office in the United States. Treas. Reg. secs. 1.6049-4(b)(5) and 1.6049-8. The IRS publishes lists of the countries whose residents are subject to the reporting requirements, and those countries with respect to which the reported information will be automatically exchanged. Rev. Proc. 2017-31, available at https://www.irs.gov/pub/irs-drop/rp-17-31.pdf, supplementing Rev. Proc. 2014-64.

(including original issue discount) that is paid on an obligation that is in registered form and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the beneficial owner is not a U.S. person.[688] For obligations issued before March 19, 2012, portfolio interest also includes interest paid on an obligation that is not in registered form, provided that the obligation is shown to be targeted to foreign investors under the conditions sufficient to establish deductibility of the payment of such interest.[689] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[690] certain contingent interest,[691] interest received by a controlled foreign corporation from a related person,[692] or interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business.[693]

Imposition of gross-basis tax and reporting by U.S. withholding agents

The 30-percent tax on FDAP income is generally collected by means of withholding.[694] Withholding on FDAP payments to foreign payees is required unless the withholding agent,[695] *i.e.*, the person making the payment to the foreign person receiving the income, can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under an income tax treaty.[696] The principal statutory exemptions from the 30-percent tax apply to interest on bank deposits, and portfolio interest, described above.[697]

In many instances, the income subject to withholding is the only income of the foreign recipient that is subject to any U.S. tax. No U.S. Federal income tax return from the foreign

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[688] Sec. 871(h)(2).

[689] Sec. 163(f)(2)(B). The exception to the registration requirements for foreign targeted securities was repealed in 2010, effective for obligations issued two years after enactment, thus narrowing the portfolio interest exemption for obligations issued after March 18, 2012. See Hiring Incentives to Restore Employment Law of 2010, Pub. L. No. 111-147, sec. 502(b).

[690] Sec. 871(h)(3).

[691] Sec. 871(h)(4).

[692] Sec. 881(c)(3)(C).

[693] Sec. 881(c)(3)(A).

[694] Secs. 1441, 1442.

[695] Withholding agent is defined broadly to include any U.S. or foreign person that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding. Treas. Reg. sec. 1.1441-7(a).

[696] Secs. 871, 881, 1441, 1442; Treas. Reg. sec. 1.1441-1(b).

[697] A reduced rate of withholding of 14 percent applies to certain scholarships and fellowships paid to individuals temporarily present in the United States. Sec. 1441(b). In addition to statutory exemptions, the 30-percent tax with respect to interest, dividends and royalties may be reduced or eliminated by a tax treaty between the United States and the country in which the recipient of income otherwise subject to tax is resident.

recipient is generally FHRA required with respect to the income from which tax was withheld, if the recipient has no ECI income and the withholding is sufficient to satisfy the recipient's liability. Accordingly, although the 30-percent gross-basis tax is a withholding tax, it is also generally the final tax liability of the foreign recipient (unless the foreign recipients files for a refund).

A withholding agent that makes payments of U.S.-source amounts to a foreign person is required to report and pay over any amounts of U.S. tax withheld. The reports are due to be filed with the IRS by March 15 of the calendar year following the year in which the payment is made. Two types of reports are required: (1) a summary of the total U.S.-source income paid and withholding tax withheld on foreign persons for the year and (2) a report to both the IRS and the foreign person of that person's U.S.-source income that is subject to reporting.[698] The nonresident withholding rules apply broadly to any financial institution or other payor, including foreign financial institutions.[699]

To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the recipient of the income.[700] If the agent withholds more than is required, and results in an overpayment of tax, the excess may be refunded to the recipient of the income upon filing of a timely claim for refund.

Excise tax on foreign reinsurance premiums

An excise tax applies to premiums paid to foreign insurers and reinsurers covering U.S. risks.[701] The excise tax is imposed on a gross basis at the rate of one percent on reinsurance and life insurance premiums, and at the rate of four percent on property and casualty insurance premiums. The excise tax does not apply to premiums that are effectively connected with the conduct of a U.S. trade or business or that are exempted from the excise tax under an applicable income tax treaty. The excise tax paid by one party cannot be credited if, for example, the risk is reinsured with a second party in a transaction that is also subject to the excise tax.

Many U.S. tax treaties provide an exemption from the excise tax, including the treaties with Germany, Japan, Switzerland, and the United Kingdom.[702] To prevent persons from inappropriately obtaining the benefits of exemption from the excise tax, the treaties generally include an anti-conduit rule. The most common anti-conduit rule provides that the treaty exemption applies to the excise tax only to the extent that the risks covered by the premiums are

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698 Treas. Reg. sec. 1.1461-1(b), (c).

699 See Treas. Reg. sec. 1.1441-7(a) (definition of withholding agent includes foreign persons).

700 Sec. 1462.

701 Secs. 4371-4374.

702 Generally, when a foreign person qualifies for benefits under such a treaty, the United States is not permitted to collect the insurance premiums excise tax from that person.

not reinsured with a person not entitled to the benefits of the treaty (or any other treaty that provides exemption from the excise tax).[703]

2. Net-basis taxation of U.S.-source income

The United States taxes on a net basis the income of foreign persons that is "effectively connected" with the conduct of a trade or business in the United States.[704] Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is not taken into account in determining the rates of U.S. tax applicable to the person's income from the business.[705]

U.S. trade or business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in the conduct of a trade or business within the United States if the partnership, estate, or trust is so engaged.[706]

The question whether a foreign person is engaged in a U.S. trade or business is factual and has generated much case law. Basic issues include whether the activity constitutes business rather than investing, whether sufficient activities in connection with the business are conducted in the United States, and whether the relationship between the foreign person and persons performing functions in the United States in respect of the business is sufficient to attribute those functions to the foreign person.

The trade or business rules differ from one activity to another. The term "trade or business within the United States" expressly includes the performance of personal services within the United States.[707] If, however, a nonresident alien individual performs personal services for a foreign employer, and the individual's total compensation for the services and period in the United States are minimal ($3,000 or less in total compensation and 90 days or fewer of physical presence in a year), the individual is not considered to be engaged in a U.S.

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[703] In Rev. Rul. 2008-15, 2008-1 C.B. 633, the IRS provided guidance to the effect that the excise tax is imposed separately on each reinsurance policy covering a U.S. risk. Thus, if a U.S. insurer or reinsurer reinsures a U.S. risk with a foreign reinsurer, and that foreign reinsurer in turn reinsures the risk with a second foreign reinsurer, the excise tax applies to both the premium to the first foreign reinsurer and the premium to the second foreign reinsurer. In addition, if the first foreign reinsurer is resident in a jurisdiction with a tax treaty containing an excise tax exemption, the revenue ruling provides that the excise tax still applies to both payments to the extent that the transaction violates an anti-conduit rule in the applicable tax treaty. Even if no violation of an anti-conduit rule occurs, under the revenue ruling, the excise tax still applies to the premiums paid to the second foreign reinsurer, unless the second foreign reinsurer is itself entitled to an excise tax exemption.

[704] Secs. 871(b), 882.

[705] Secs. 871(b)(2), 882(a)(2).

[706] Sec. 875.

[707] Sec. 864(b).

trade or business.[708] Detailed rules govern whether trading in stocks or securities or commodities constitutes the conduct of a U.S. trade or business.[709] A foreign person who trades in stock or securities or commodities in the United States through an independent agent generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out. A foreign person who trades stock or securities or commodities for the person's own account also generally is not considered to be engaged in a U.S. business so long as the foreign person is not a dealer in stock or securities or commodities.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Under each treaty, the United States is permitted to tax business profits only to the extent those profits are attributable to a U.S. permanent establishment of the foreign person. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business. For example, a permanent establishment typically requires the maintenance of a fixed place of business over a significant period of time.

Effectively connected income

A foreign person that is engaged in the conduct of a trade or business within the United States is subject to U.S. net-basis taxation on the income that is "effectively connected" with the business. Specific statutory rules govern whether income is ECI.[710]

In the case of U.S.-source capital gain and U.S.-source income of a type that would be subject to gross basis U.S. taxation, the factors taken into account in determining whether the income is ECI include whether the income is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests).[711] Under the asset use and business activities tests, due regard is given to whether the income, gain, or asset was accounted for through the U.S. trade or business. All other U.S.-source income is treated as ECI.[712]

[708] Sec. 864(b)(1).

[709] Sec. 864(b)(2).

[710] Sec. 864(c).

[711] Sec. 864(c)(2).

[712] Sec. 864(c)(3).

A foreign person who is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered to be ECI.[713] Foreign-source income not included in one of these categories (described next) generally is exempt from U.S. tax.

A foreign person's income from foreign sources generally is considered to be ECI only if the person has an office or other fixed place of business within the United States to which the income is attributable and the income is in one of the following categories: (1) rents or royalties for the use of patents, copyrights, secret processes or formulas, good will, trade-marks, trade brands, franchises, or other like intangible properties derived in the active conduct of the trade or business; (2) interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; or (3) income derived from the sale or exchange (outside the United States), through the U.S. office or fixed place of business, of inventory or property held by the foreign person primarily for sale to customers in the ordinary course of the trade or business, unless the sale or exchange is for use, consumption, or disposition outside the United States and an office or other fixed place of business of the foreign person in a foreign country participated materially in the sale or exchange.[714] Foreign-source dividends, interest, and royalties are not treated as ECI if the items are paid by a foreign corporation more than 50 percent (by vote) of which is owned directly, indirectly, or constructively by the recipient of the income.[715]

In determining whether a foreign person has a U.S. office or other fixed place of business, the office or other fixed place of business of an agent generally is disregarded. The place of business of an agent other than an independent agent acting in the ordinary course of business is not disregarded, however, if the agent either has the authority (regularly exercised) to negotiate and conclude contracts in the name of the foreign person or has a stock of merchandise from which he regularly fills orders on behalf of the foreign person.[716] If a foreign person has a U.S. office or fixed place of business, income, gain, deduction, or loss is not considered attributable to the office unless the office was a material factor in the production of the income, gain, deduction, or loss and the office regularly carries on activities of the type from which the income, gain, deduction, or loss was derived.[717]

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[713] This income is subject to net-basis U.S. taxation after allowance of a credit for any foreign income tax imposed on the income. Sec. 906.

[714] Sec. 864(c)(4)(B).

[715] Sec. 864(c)(4)(D)(i).

[716] Sec. 864(c)(5)(A).

[717] Sec. 864(c)(5)(B).

Special rules apply in determining the ECI of an insurance company. The foreign-source income of a foreign corporation that is subject to tax under the insurance company provisions of the Code is treated as ECI if the income is attributable to its United States business.[718]

Income, gain, deduction, or loss for a particular year generally is not treated as ECI if the foreign person is not engaged in a U.S. trade or business in that year.[719] If, however, income or gain taken into account for a taxable year is attributable to the sale or exchange of property, the performance of services, or any other transaction that occurred in a prior taxable year, the determination whether the income or gain is taxable on a net basis is made as if the income were taken into account in the earlier year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the later taxable year.[720] If any property ceases to be used or held for use in connection with the conduct of a U.S. trade or business and the property is disposed of within 10 years after the cessation, the determination whether any income or gain attributable to the disposition of the property is taxable on a net basis is made as if the disposition occurred immediately before the property ceased to be used or held for use in connection with the conduct of a U.S. trade or business and without regard to the requirement that the taxpayer be engaged in a U.S. business during the taxable year for which the income or gain is taken into account.[721]

Transportation income from U.S. sources is treated as effectively connected with a foreign person's conduct of a U.S. trade or business only if the foreign person has a fixed place of business in the United States that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation.[722] If the transportation income is effectively connected with conduct of a U.S. trade or business, the transportation income, along with transportation income that is from U.S. sources because the transportation both begins and ends in the United States, may be subject to net-basis taxation. Income from the international operation of a ship or aircraft may be eligible for an exemption under section 883, provided that the foreign jurisdiction has extended reciprocity for U.S.

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[718] Sec. 864(c)(4)(C).

[719] Sec. 864(c)(1)(B).

[720] Sec. 864(c)(6).

[721] Sec. 864(c)(7).

[722] Sec. 887(b)(4).

businesses;[723] whether the party claiming an exemption is eligible for the tax relief;[724] and the activities that give rise to the income qualify under relevant regulations.

Allowance of deductions

Taxable ECI is computed by taking into account deductions associated with gross ECI. For this purpose, the apportionment and allocation of deductions is addressed in detailed regulations. The regulations applicable to deductions other than interest expense set forth general guidelines for allocating deductions among classes of income and apportioning deductions between ECI and non-ECI. In some circumstances, deductions may be allocated on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries paid, space used, time spent, or gross income received. More specific guidelines are provided for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. Detailed regulations under section 861 address the allocation and apportionment of interest deductions. In general, interest is allocated and apportioned based on assets rather than income.

3. Special rules

FIRPTA

A foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") is treated as ECI and, therefore, as taxable at the income tax rates applicable to U.S. persons, including the rates for net capital gain. A foreign person subject to tax on this income is required to file a U.S. tax return under the normal rules relating to receipt of ECI.[725] In the case of a foreign corporation, the gain from the disposition of a USRPI may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate).

The payor of income that FIRPTA treats as ECI ("FIRPTA income") is generally required to withhold U.S. tax from the payment.[726] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's total ECI and deductions (if any) for the taxable year.

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723 The most recent compilation of countries that the United States recognizes as providing exemptions lists countries in three groups: Twenty-seven countries are eligible for exemption on the basis of a review of the legislation in the foreign jurisdiction; 39 nations exchanged diplomatic notes with the United States that grant exemption to some extent; and more than 50 nations are parties with the United States to bilateral income tax treaties that include a shipping article. Rev. Rul. 2008-17, 2008-1 C.B. 626, modified by Ann. 2008-57, 2008-C.B. 1192, 2008.

724 Sec. 883(c) and regulations thereunder.

725 Sec. 897(a).

726 Sec. 1445 and Treasury regulations thereunder.

Branch profits taxes

A domestic corporation owned by foreign persons is subject to U.S. income tax on its net income. The earnings of the domestic corporation are subject to a second tax, this time at the shareholder level, when dividends are paid. As described previously, when the shareholders are foreign, the second-level tax is imposed at a flat rate and collected by withholding. Unless the portfolio interest exemption or another exemption applies, interest payments made by a domestic corporation to foreign creditors are likewise subject to U.S. tax. To approximate these second-level withholding taxes imposed on payments made by domestic subsidiaries to their foreign parent corporations, the United States taxes a foreign corporation that is engaged in a U.S. trade or business through a U.S. branch on amounts of U.S. earnings and profits that are shifted out of, or amounts of interest that are deducted by, the U.S. branch of the foreign corporation. These branch taxes may be reduced or eliminated under an applicable income tax treaty.[727]

Under the branch profits tax, the United States imposes a tax of 30 percent on a foreign corporation's "dividend equivalent amount."[728] The dividend equivalent amount generally is the earnings and profits of a U.S. branch of a foreign corporation attributable to its ECI.[729] Limited categories of earnings and profits attributable to a foreign corporation's ECI are excluded in calculating the dividend equivalent amount.[730]

In arriving at the dividend equivalent amount, a branch's effectively connected earnings and profits are adjusted to reflect changes in a branch's U.S. net equity (that is, the excess of the branch's assets over its liabilities, taking into account only amounts treated as connected with its U.S. trade or business).[731] The first adjustment reduces the dividend equivalent amount to the extent the branch's earnings are reinvested in trade or business assets in the United States (or reduce U.S. trade or business liabilities). The second adjustment increases the dividend equivalent amount to the extent prior reinvested earnings are considered remitted to the home office of the foreign corporation.

Interest paid by a U.S. trade or business of a foreign corporation generally is treated as if paid by a domestic corporation and therefore is subject to U.S. 30-percent withholding tax (if the interest is paid to a foreign person and a Code or treaty exemption or reduction would not be available if the interest were actually paid by a domestic corporation).[732] Certain "excess interest" of a U.S. trade or business of a foreign corporation is treated as if paid by a U.S.

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[727] See Treas. Reg. sec. 1.884-1(g), -5.

[728] Sec. 884(a).

[729] Sec. 884(b).

[730] See sec. 884(d)(2) (excluding, for example, earnings and profits attributable to gain from the sale of domestic corporation stock that constitutes a U.S. real property interest described in section 897.

[731] Sec. 884(b).

[732] Sec. 884(f)(1)(A).

corporation to a foreign parent and, therefore, is subject to U.S. 30-percent withholding tax.[733] For this purpose, excess interest is the excess of the interest expense of the foreign corporation apportioned to the U.S. trade or business over the amount of interest paid by the trade or business.

Earnings stripping

Taxpayers are limited in their ability to reduce the U.S. tax on the income derived from their U.S. operations through certain earnings stripping transactions that involve interest payments. If the payor's debt-to-equity ratio exceeds 1.5 to 1 (a debt-to-equity ratio of 1.5 to 1 or less is considered a "safe harbor"), a deduction for disqualified interest paid or accrued by the payor in a taxable year is generally disallowed to the extent of the payor's excess interest expense.[734] Disqualified interest includes interest paid or accrued to related parties when no Federal income tax is imposed with respect to such interest;[735] to unrelated parties in certain instances in which a related party guarantees the debt ("guaranteed debt"); or to a REIT by a taxable REIT subsidiary of that REIT. Excess interest expense is the amount by which the payor's net interest expense (that is, the excess of interest paid or accrued over interest income) exceeds 50 percent of its adjusted taxable income (generally taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Interest amounts disallowed under these rules can be carried forward indefinitely and are allowed as a deduction to the extent of excess limitation in a subsequent tax year. In addition, any excess limitation (that is, the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.

[733] Sec. 884(f)(1)(B).

[734] Sec. 163(j).

[735] If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed under the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

D. U.S. Tax Rules Applicable to Foreign Activities of U.S. Persons (Outbound)

1. In general

In general, income earned directly by a U.S. person from the conduct of a foreign business is taxed on a current basis,[736] but income earned indirectly from a separate legal entity operating the foreign business is not. Instead, active foreign business income earned by a U.S. person indirectly through an interest in a foreign corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. person. Certain anti-deferral regimes may cause the U.S. owner to be taxed on a current basis in the United States on certain categories of passive or highly mobile income earned by the foreign corporation regardless of whether the income has been distributed as a dividend to the U.S. owner. The main anti-deferral regimes that provide such exceptions are the controlled foreign corporation ("CFC") rules of subpart F[737] and the passive foreign investment company ("PFIC") rules.[738] A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether the income is earned directly by the domestic corporation, repatriated as an actual dividend, or included in the domestic parent corporation's income under one of the anti-deferral regimes.[739]

2. Anti-deferral regimes

Subpart F

Subpart F,[740] applicable to CFCs and their shareholders, is the main anti-deferral regime of relevance to a U.S.-based multinational corporate group. A CFC generally is defined as any foreign corporation if U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that are within the meaning of the term "United States shareholder," which refers only to those U.S. persons who own at least 10 percent of the stock (measured by vote only).[741]

Subpart F income

Under the subpart F rules, the United States generally taxes the 10-percent U.S. shareholders of a CFC on their pro rata shares of certain income of the CFC (referred to as

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[736] A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs under section 911. For a description of this exclusion, see *Present Law and Issues in U.S. Taxation of Cross-Border Income* (JCX-42-11), September 6, 2011, p. 52.

[737] Secs. 951-964.

[738] Secs. 1291-1298.

[739] Secs. 901, 902, 960, 1293(f).

[740] Secs. 951-964.

[741] Secs. 951(b), 957, 958. The term "United States shareholder" is used interchangeably herein with "U.S. shareholder."

"subpart F income"), without regard to whether the income is distributed to the shareholders.[742] In effect, the United States treats the 10-percent U.S. shareholders of a CFC as having received a current distribution of the corporation's subpart F income. With exceptions described below, subpart F income generally includes passive income and other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,[743] insurance income,[744] and certain income relating to international boycotts and other violations of public policy.[745]

Foreign base company income consists of foreign personal holding company income, which includes passive income such as dividends, interest, rents, and royalties, and a number of categories of income from business operations, including foreign base company sales income, foreign base company services income, and foreign base company oil-related income.[746]

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Finally, special rules apply under subpart F with respect to related person insurance income[747] in order to address captive insurance companies.[748] Under these rules, the threshold for determining control is reduced to 25 percent, and any level of stock ownership by a U.S. person in such corporation is sufficient for the person to be treated as a U.S. shareholder.

Investments in U.S. property

The 10-percent U.S. shareholders of a CFC also are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's untaxed earnings invested

[742] Sec. 951(a).

[743] Sec. 954.

[744] Sec. 953.

[745] Sec. 952(a)(3)-(5).

[746] Sec. 954.

[747] Sec. 953(c). Related person insurance income is defined for this purpose to mean any insurance income attributable to a policy of insurance or reinsurance with respect to which the primary insured is either a U.S. shareholder (within the meaning of the provision) in the foreign corporation receiving the income or a person related to such a shareholder.

[748] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987, p. 968.

in certain items of U.S. property.[749] This U.S. property generally includes tangible property located in the United States, stock of a U.S. corporation, an obligation of a U.S. person, and certain intangible assets, such as patents and copyrights, acquired or developed by the CFC for use in the United States.[750] There are specific exceptions to the general definition of U.S. property, including for bank deposits, certain export property, and certain trade or business obligations.[751] The inclusion rule for investment of earnings in U.S. property is intended to prevent taxpayers from avoiding U.S. tax on dividend repatriations by repatriating CFC earnings through non-dividend payments, such as loans to U.S. persons.

Subpart F exceptions

Several exceptions to the broad definition of subpart F income permit continued deferral for income from certain transactions, dividends, interest and certain rents and royalties received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized.[752] The same-country exception is not available to the extent that the payments reduce the subpart F income of the payor. A second exception from foreign base company income and insurance income is available for any item of income received by a CFC if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90 percent of the maximum U.S. corporate income tax rate (that is, more than 90 percent of 35 percent, or 31.5 percent).[753]

A provision colloquially referred to as the "CFC look-through" rule excludes from foreign personal holding company income dividends, interest, rents, and royalties received or accrued by one CFC from a related CFC (with relation based on control) to the extent attributable or properly allocable to non-subpart-F income of the payor.[754] The look-through rule applies to taxable years of foreign corporations beginning before January 1, 2020, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.[755]

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[749] Secs. 951(a)(1)(B), 956.

[750] Sec. 956(c)(1).

[751] Sec. 956(c)(2).

[752] Sec. 954(c)(3).

[753] Sec. 954(b)(4).

[754] Sec. 954(c)(6).

[755] See section 144 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Pub. L. No. 114-113), H.R. 2029 ["the PATH Act of 2015"], which extended section 954(c)(6) for five years. Congress has previously extended the application of section 954(c)(6) several times, most recently in the Tax Increase Prevention Act of 2014, Pub. L. No. 113-295; Pub. L. No. 107-147, sec. 614, 2002; Pub. L. No. 106-170, sec. 503, 1999; Pub. L. No. 105-277, 1998.

There is also an exclusion from subpart F income for certain income of a CFC that is derived in the active conduct of banking or financing business ("active financing income"), which applies to all taxable years of the foreign corporation beginning after December 31, 2014, and for taxable years of the shareholders that end during or within such taxable years of the corporation.[756] With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met.

In the case of a securities dealer, an exception from foreign personal holding company income applies to any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475.[757] In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that, for securities dealers, this exception generally takes precedence over the exception for active financing income.

Income is treated as active financing income only if, among other requirements, it is derived by a CFC or by a QBU of that CFC. Certain activities conducted by persons related to the CFC or its QBU are treated as conducted directly by the CFC or QBU.[758] An activity qualifies under this rule if the activity is performed by employees of the related person and if the related person is an eligible CFC, the home country of which is the same as the home country of the related CFC or QBU; the activity is performed in the home country of the related person; and the related person receives arm's-length compensation that is treated as earned in the home country. Income from an activity qualifying under this rule is excluded from subpart F income so long as the other active financing requirements are satisfied.

Certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch or within the CFC's country of creation or organization are also excepted from foreign personal holding company income, provided that certain requirements are met. Further, additional exceptions from insurance income and from

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[756] Sec. 954(h). See section 128 of the PATH Act of 2015, which made the active financing exception permanent.

[757] Sec. 954(c)(2)(C).

[758] Sec. 954(h)(3)(E).

foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions, including reserve requirements, are met.[759]

Exclusion of previously taxed earnings and profits

A 10-percent U.S. shareholder of a CFC may exclude from its income actual distributions of earnings and profits from the CFC that were previously included in the 10-percent U.S. shareholder's income under subpart F.[760] Any income inclusion (under section 956) resulting from investments in U.S. property may also be excluded from the 10-percent U.S. shareholder's income when such earnings are ultimately distributed.[761] Ordering rules provide that distributions from a CFC are treated as coming first out of earnings and profits of the CFC that have been previously taxed under subpart F, then out of other earnings and profits.[762]

Basis adjustments

In general, a 10-percent U.S. shareholder of a CFC receives a basis increase with respect to its stock in the CFC equal to the amount of the CFC's earnings that are included in the 10-percent U.S. shareholder's income under subpart F.[763] Similarly, a 10-percent U.S. shareholder of a CFC generally reduces its basis in the CFC's stock in an amount equal to any distributions that the 10-percent U.S. shareholder receives from the CFC that are excluded from its income as previously taxed under subpart F.[764]

Passive foreign investment companies

The Tax Reform Act of 1986[765] established the PFIC anti-deferral regime. A PFIC is generally defined as any foreign corporation if 75 percent or more of its gross income for the taxable year consists of passive income, or 50 percent or more of its assets consists of assets that

[759] Subject to approval by the IRS, a taxpayer may establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

[760] Sec. 959(a)(1).

[761] Sec. 959(a)(2).

[762] Sec. 959(c).

[763] Sec. 961(a).

[764] Sec. 961(b).

[765] Pub. L. No. 99-514.

produce, or are held for the production of, passive income.[766] Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a PFIC, regardless of their percentage ownership in the company. One set of rules applies to PFICs that are qualified electing funds, under which electing U.S. shareholders currently include in gross income their respective shares of the company's earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.[767] A second set of rules applies to PFICs that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of deferral.[768] A third set of rules applies to PFIC stock that is marketable, under which electing U.S. shareholders currently take into account as income (or loss) the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."[769]

Under the PFIC regime, passive income is any income which is of a kind that would be foreign personal holding company income, including dividends, interest, royalties, rents, and certain gains on the sale or exchange of property, commodities, or foreign currency. However, among other exceptions, passive income does not include any income derived in the active conduct of an insurance business by a corporation that is predominantly engaged in an insurance business and that would be subject to tax under subchapter L if it were a domestic corporation.[770] In applying the insurance exception, the IRS analyzes whether risks assumed under contracts issued by a foreign company organized as an insurer are truly insurance risks, whether the risks are limited under the terms of the contracts, and the status of the company as an insurance company.[771]

Other anti-deferral rules

The subpart F and PFIC rules are not the only anti-deferral regimes. Other rules that impose current U.S. taxation on income earned through corporations include the accumulated earnings tax rules[772] and the personal holding company rules.

Rules for coordination among the anti-deferral regimes are provided to prevent U.S. persons from being subject to U.S. tax on the same item of income under multiple regimes. For

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[766] Sec. 1297.

[767] Secs. 1293-1295.

[768] Sec. 1291.

[769] Sec. 1296.

[770] Sec. 1297(b)(2)(B).

[771] Notice 2003-34, 2003-C.B. 1 990, June 9, 2003. See also, Prop. Treas. Reg. sec. 1.1297-4, 26 CFR Part 1, REG-108214-15, April 24, 2015.

[772] Secs. 531-537.

example, a corporation generally is not treated as a PFIC with respect to a particular shareholder if the corporation is also a CFC and the shareholder is a 10-percent U.S. shareholder. Thus, subpart F is allowed to trump the PFIC rules.

3. Foreign tax credit

Subject to certain limitations, U.S. citizens, resident individuals, and domestic corporations are allowed to claim credit for foreign income taxes they pay. A domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation is allowed a "deemed-paid" credit for foreign income taxes paid by the foreign corporation that the domestic corporation is deemed to have paid when the related income is distributed as a dividend or is included in the domestic corporation's income under the anti-deferral rules.[773]

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign-source taxable income (as determined under U.S. tax accounting principles). This limit is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[774] The limit is computed by multiplying a taxpayer's total U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year. If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may carry back the excess foreign taxes to the previous year or carry forward the excess taxes to one of the succeeding 10 years.[775]

The computation of the foreign tax credit limitation requires a taxpayer to determine the amount of its taxable income from foreign sources in each limitation category (described below) by allocating and apportioning deductions between U.S.-source gross income, on the one hand, and foreign-source gross income in each limitation category, on the other. In general, deductions are allocated and apportioned to the gross income to which the deductions factually relate.[776] However, subject to certain exceptions, deductions for interest expense and research and experimental expenses are apportioned based on taxpayer ratios.[777] In the case of interest expense, this ratio is the ratio of the corporation's foreign or domestic (as applicable) assets to its worldwide assets. In the case of research and experimental expenses, the apportionment ratio is based on either sales or gross income. All members of an affiliated group of corporations

[773] Secs. 901, 902, 960, 1291(g).

[774] Secs. 901, 904.

[775] Sec. 904(c).

[776] Treas. Reg. sec. 1.861-8(b), Temp. Treas. Reg. sec. 1.861-8T(c).

[777] Temp. Treas. Reg. sec. 1.861-9T, Treas. Reg. sec. 1.861-17.

generally are treated as a single corporation for purposes of determining the apportionment ratios.[778]

The term "affiliated group" is determined generally by reference to the rules for determining whether corporations are eligible to file consolidated returns.[779] These rules exclude foreign corporations from an affiliated group.[780] Interest expense allocation rules permitting a U.S. affiliated group to apportion the interest expense of the members of the U.S. affiliated group on a worldwide-group basis were modified in 2004, and initially effective for taxable years beginning after December 31, 2008.[781] The effective date of the modified rules has been delayed to January 1, 2021.[782] A result of this rule is that interest expense of foreign members of a U.S. affiliated group is taken into account in determining whether a portion of the interest expense of the domestic members of the group must be allocated to foreign-source income. An allocation to foreign-source income generally is required only if, in broad terms, the domestic members of the group are more highly leveraged than is the entire worldwide group. The new rules are generally expected to reduce the amount of the U.S. group's interest expense that is allocated to foreign-source income.

The foreign tax credit limitation is applied separately to passive category income and to general category income.[783] Passive category income includes passive income, such as portfolio interest and dividend income, and certain specified types of income. All other income is in the general category. Passive income is treated as general category income if it is earned by a qualifying financial services entity. Passive income is also treated as general category income if it is highly taxed (that is, if the foreign tax rate is determined to exceed the highest rate of tax specified in Code section 1 or 11, as applicable). Dividends (and subpart F inclusions), interest, rents, and royalties received by a 10-percent U.S. shareholder from a CFC are assigned to a separate limitation category by reference to the category of income out of which the dividends or

[778] Sec. 864(e)(1), (6); Temp. Treas. Reg. sec. 1.861-14T(e)(2).

[779] Secs. 864(e)(5), 1504.

[780] Sec. 1504(b)(3).

[781] Sec. 864(f); "American Jobs Creation Act of 2004" ("AJCA"), Pub. L. 108-357, sec. 401(a).

[782] Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, sec. 551(a).

[783] Sec. 904(d). AJCA generally reduced the number of income categories from nine to two, effective for tax years beginning in 2006. Before AJCA, the foreign tax credit limitation was applied separately to the following categories of income: (1) passive income, (2) high withholding tax interest, (3) financial services income, (4) shipping income, (5) certain dividends received from noncontrolled section 902 foreign corporations (also known as "10/50 companies"), (6) certain dividends from a domestic international sales corporation or former domestic international sales corporation, (7) taxable income attributable to certain foreign trade income, (8) certain distributions from a foreign sales corporation or former foreign sales corporation, and (9) any other income not described in items (1) through (8) (so-called "general basket" income). A number of other provisions of the Code, including several enacted in 2010 as part of Pub. L. No. 111-226, create additional separate categories in specific circumstances or limit the availability of the foreign tax credit in other ways. See, *e.g.*, secs. 865(h), 901(j), 904(d)(6), 904(h)(10).

other payments were made.[784] Dividends received by a 10-percent corporate shareholder of a foreign corporation that is not a CFC are also categorized on a look-through basis.[785]

Special rules apply to the allocation of income and losses from foreign and U.S. sources within each category of income.[786] Foreign losses from one category will first be used to offset income from foreign sources of other categories. If there remains an overall foreign loss, it will be deducted against income from U.S. sources. The same principle applies to losses from U.S. sources. In subsequent years, the losses that were deducted against another category or source of income will be recaptured. That is, an equal amount of income from the same category or source that generated a loss in the prior year will be recharacterized as income from the other category or source against which the loss was deducted. Up to 50 percent of income from one source in any subsequent year will be recharacterized as income from the other source, whereas foreign-source income in a particular category can be fully recharacterized as income in another category until the losses from prior years are fully recaptured.[787]

In addition to the foreign tax credit limitation just described, a taxpayer's ability to claim a foreign tax credit may be further limited by a matching rule that prevents the separation of creditable foreign taxes from the associated foreign income. Under this rule, a foreign tax generally is not taken into account for U.S. tax purposes, and thus no foreign tax credit is available with respect to that foreign tax, until the taxable year in which the related income is taken into account for U.S. tax purposes.[788]

4. Special rules

Dual consolidated loss rules

Under the rules applicable to corporations filing consolidated returns, a dual consolidated loss ("DCL") is any net operating loss of a domestic corporation if the corporation is subject to an income tax of a foreign country without regard to whether such income is from sources in or outside of such foreign country, or if the corporation is subject to such a tax on a residence basis (a "dual resident corporation").[789] A DCL generally cannot be used to reduce the taxable income of any member of the corporation's affiliated group. Losses of a separate unit of a domestic corporation (a foreign branch or an interest in a hybrid entity owned by the corporation) are subject to this limitation in the same manner as if the unit were a wholly owned subsidiary of

[784] Sec. 904(d)(3). The subpart F rules applicable to CFCs and their 10-percent U.S. shareholders are described below.

[785] Sec. 904(d)(4).

[786] Secs. 904(f), (g).

[787] Secs. 904(f)(1), (g)(1).

[788] Sec. 909.

[789] Sec. 1503(d).

such corporation. An exemption is available under Treasury regulations in the case of DCLs for which a domestic use election (that is, an election to use the loss only for domestic, and not foreign, tax purposes) has been made.[790] Recapture is required, however, upon the occurrence of certain triggering events, including the conversion of a separate unit to a foreign corporation and the transfer of 50 percent or more of the assets of a separate unit within a twelve-month period.[791]

Temporary dividends-received deduction for repatriated foreign earnings

AJCA section 421 added to the Code section 965, a temporary provision intended to encourage U.S. multinational companies to repatriate foreign earnings. Under section 965, for one taxable year certain dividends received by a U.S. corporation from its CFCs were eligible for an 85-percent dividends-received deduction. At the taxpayer's election, this deduction was available for dividends received either during the taxpayer's first taxable year beginning on or after October 22, 2004, or during the taxpayer's last taxable year beginning before such date.

The temporary deduction was subject to a number of general limitations. First, it applied only to cash repatriations generally in excess of the taxpayer's average repatriation level calculated for a three-year base period preceding the year of the deduction. Second, the amount of dividends eligible for the deduction was generally limited to the amount of earnings shown as permanently invested outside the United States on the taxpayer's recent audited financial statements. Third, to qualify for the deduction, dividends were required to be invested in the United States according to a domestic reinvestment plan approved by the taxpayer's senior management and board of directors.[792]

No foreign tax credit (or deduction) was allowed for foreign taxes attributable to the deductible portion of any dividend.[793] For this purpose, the taxpayer was permitted to specifically identify which dividends were treated as carrying the deduction and which dividends were not. In other words, the taxpayer was allowed to choose which of its dividends were treated as meeting the base-period repatriation level (and thus carry foreign tax credits, to the extent otherwise allowable), and which of its dividends were treated as part of the excess eligible for the deduction (and thus subject to proportional disallowance of any associated foreign tax

[790] Treas. Reg. sec. 1.1503(d)-6(d).

[791] See Treas. Reg. sec. 1.1503(d)-6(e)(1).

[792] Section 965(b)(4). The plan was required to provide for the reinvestment of the repatriated dividends in the United States, including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, and the financial stabilization of the corporation for the purposes of job retention or creation.

[793] Sec. 965(d)(1).

credits).[794] Deductions were disallowed for expenses that were directly allocable to the deductible portion of any dividend.[795]

Domestic international sales corporations

A domestic international sales corporations ("DISC") is a domestic corporation that satisfies the following conditions: 95 percent of its gross receipts must be qualified export receipts; 95 percent of the sum of the adjusted bases of all its assets must be attributable to the sum of the adjusted bases of qualified export assets; the corporation must have no more than one class of stock; the par or stated value of the outstanding stock must be at least $2,500 on each day of the taxable year; and an election must be in effect to be taxed as a DISC.[796] In general, a DISC is not subject to corporate-level tax and offers limited deferral of tax liability to its shareholders.[797] DISC income attributable to a maximum of $10 million annually of qualified export receipts is generally exempt from income tax at both the corporate and shareholder level. Shareholders must pay interest to account for the benefit of deferring the tax liability on undistributed DISC income related to this $10 million maximum annual amount.[798] Such entities are also referred to as interest charge DISCs, or IC-DISCs. Shareholders of a DISC are deemed to receive a dividend out of current earnings and profits from qualified export receipts in excess of $10 million.[799] Gain on the sale of DISC stock is treated as a dividend to the extent of accumulated DISC income.[800] The shareholders of a corporation which is not a DISC, but was a DISC in a previous taxable year, and which has previously taxed income or accumulated DISC income, are also required to pay interest on the deferral benefit, and gain on the sale or exchange of stock in such corporation is treated as a dividend.

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[794] Accordingly, taxpayers generally were expected to pay regular dividends out of high-taxed CFC earnings (thereby generating deemed-paid credits available to offset foreign-source income) and section 965 dividends out of low-taxed CFC earnings (thereby availing themselves of the 85-percent deduction).

[795] Sec. 965(d)(2).

[796] Secs. 992(a) and (b). If a corporation fails to satisfy either or both of the 95-percent tests, it is deemed to satisfy such tests if it makes a pro rata distribution of its gross receipts which are not qualified export receipts and the fair market value of its assets which are not qualified export assets. Sec. 992(c).

[797] Sec. 991. Prior to the 1984 Revenue Act (Pub. L. 98-369), DISCs were eligible for more generous tax benefits that were eliminated in favor of the since-repealed foreign sales corporation regime ("FSC"). An overview of the history of the DISCs and FSCs regimes is provided in Joseph Isenbergh, Vol. 3 *U.S. Taxation of Foreign Persons and Foreign Income*, Para. 81. (Fourth Ed. 2016).

[798] The rate is the average of one-year constant maturity Treasury yields. The deferral benefit is the excess of the amount of tax for which the shareholder would be liable if deferred DISC income were included as ordinary income over the actual tax liability of such shareholder. Sec. 995(f).

[799] The amount of the deemed distribution is the sum of several items, including qualified export receipts in excess of $10 million. See sec. 955(b).

[800] Sec. 995(c).

IV. INTERNATIONAL TAX REFORM

A. Establishment of Participation Exemption System for Taxation of Foreign Income

1. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations

Description of Proposal

In general

The proposal provides for an exemption for certain foreign income. This exemption is provided for by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) [801] (referred to here as "DRD").

A specified 10-percent owned foreign corporation is any foreign corporation (other than a PFIC that is not also a CFC) with respect to which any domestic corporation is a U.S. shareholder.[802]

Foreign-source portion of a dividend

The DRD is available only for the foreign-source portion of dividends received by a domestic corporation from specified 10-percent owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the undistributed foreign earnings bears to the total undistributed earnings. Undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation[803] as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed and not reduced by dividends[804] distributed during that taxable year. Undistributed foreign earnings are the portion of the undistributed earnings attributable to neither income described in section 245(a)(5)(A) nor section 245(a)(5)(B), without regard to section 245(a)(12).

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[801] Under section 951(b), a domestic corporation is a United States shareholder of a foreign corporation if it owns, within the meaning of section 958(a), or is considered as owning by applying the rules of section 958(b), 10 percent or more of the voting stock of the foreign corporation.

[802] Secs. 1297, 1298.

[803] Computed in accordance with secs. 964(a) and 986.

[804] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

Hybrid dividends

The DRD is not available for any dividend received by a U.S. shareholder from a controlled foreign corporation if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a controlled foreign corporation for which a deduction would be allowed under this proposal and for which the specified 10-percent owned foreign corporation received a deduction (or other tax benefit) from taxes imposed by a foreign country.

If a controlled foreign corporation with respect to which a domestic corporation is a U.S. shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which the domestic corporation is also a U.S. shareholder, then the hybrid dividend is treated for purposes of section 951(a)(1)(A) as subpart F income of the recipient controlled foreign corporation for the taxable year of the controlled foreign corporation in which the dividends was received and the U.S. shareholder includes in gross income an amount equal to the shareholder's pro rata share of the subpart F income, determined in the same manner as section 951(a)(2).

Foreign tax credit disallowance

No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a U.S. shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income (and entire taxable income) by disregarding the foreign-source portion of any dividend received from that foreign corporation for which the DRD is taken, as well as and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Holding period requirement

A domestic corporation is not permitted a DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend. For this purpose, the holding period requirement is treated as met only if the specified 10-percent owned foreign corporation is a specified 10-percent owned foreign corporation at all times during the period and the taxpayer is a U.S. shareholder with respect to such specified 10-percent owned foreign corporation at all times during the period.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017 and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Special rules relating to sales or transfers involving specified 10-percent owned foreign corporations

Description of Proposal

Sales by United States persons of stock

In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for one year or more, the proposal provides that any amount received by the domestic corporation which is treated as a dividend for purposes of section 1248, is treated as a dividend for purposes of applying the proposal.

Reduction in basis of certain foreign stock

Solely for the purpose of determining a loss, a domestic corporate shareholder's adjusted basis in the stock of a specified 10-percent owned foreign corporation (as defined in this proposal) is reduced by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a dividends received deduction allowable under section 245A in any taxable year of such domestic corporation. This rule applies in coordination with section 1059, such that any reduction in basis required pursuant to this proposal will be disregarded, to the extent the basis in the specified 10-percent owned foreign corporation's stock has already been reduced pursuant to section 1059.

Sale by a CFC of a lower-tier CFC

If for any taxable year of a CFC beginning after December 31, 2017, an amount is treated as a dividend under section 964(e)(1) because of a sale or exchange by the CFC of stock in another foreign corporation held for a year or more, then: (i) the foreign-source portion of the dividend is treated as subpart F income of the selling CFC for purposes of section 951(a)(1)(A), (ii) a United States shareholder with respect to the selling CFC includes in gross income for the taxable year of the shareholder with or within the taxable year of the CFC ends, an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the amount treated as subpart F income under (i), and (iii) the deduction under section 245A(a) is allowable to the United States shareholder with respect to the subpart F income included in gross income under (ii) in the same manner as if the subpart F income were a dividend received by the shareholder from the selling CFC.

In the case of a sale or exchange by a CFC of stock in another corporation in a taxable year of the selling CFC beginning after December 31, 2017, to which this proposal applies if gain were recognized, the earnings and profits of the selling controlled foreign corporation is not reduced by any loss from the sale or exchange.

Inclusion of transferred loss amount in certain assets transfers

Under the proposal, if a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of section 367(a)(3)(C)) to a specified 10-percent owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, the domestic

corporation includes in gross income an amount equal to the transferred loss amount, subject to certain limitations.

The transferred loss amount is the excess (if any) of: (1) losses incurred by the foreign branch after December 31, 2017, and before the transfer, for which a deduction was allowed to the domestic corporation, over (2) the sum of certain taxable income earned by the foreign branch and gain recognized by reason of an overall foreign loss recapture arising out of disposition of assets on account of the underlying transfer. For the purposes of (2), only taxable income of the foreign branch in taxable years after the loss is incurred through the close of the taxable year of the transfer, is included. The transferred loss amount is reduced by the amount of gain recognized by the taxpayer (other than gain recognized by reason of an overall foreign loss recapture) on account of the transfer.

The amount of loss included in the gross income of the taxpayer under the proposed rule above for any taxable year cannot exceed the amount allowed as a deduction under new section 245A for the taxable year (taking into account dividends received from all specified 10-percent owned foreign corporations with respect to which the taxpayer is a U.S. shareholder). Any amount not included in gross income for a taxable year because of this proposed rule is included in gross income in the succeeding taxable year.

Amounts included in gross income by reason of the proposal are treated as derived from sources within the United States. Consistent with regulations or guidance that the Secretary of the Treasury may prescribe, proper adjustments are made in the adjusted basis of the taxpayer's stock in the specified 10-percent owned foreign corporation to which the transfer is made, and in the transferee's adjusted basis in the property transferred, to reflect amounts included in gross income under this proposal.

Effective Date

The proposal relating to reduction of basis in certain foreign stock for the purposes of determining a loss is effective for dividends received in taxable years beginning after December 31, 2017.

The proposal relating to transfer of loss amounts from foreign branches to certain foreign corporations is effective for transfers after December 31, 2017.

3. Treatment of deferred foreign income upon transition to participation exemption system of taxation

Description of Proposal

In general

The proposal generally requires that, for the last taxable year beginning before January 1, 2018, any U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the corporation ("mandatory inclusion"). For purposes of this proposal, a specified foreign corporation is any foreign corporation that has at least one U.S. shareholder. It does not include PFICs that are not

also CFCs. A portion of that pro rata share of foreign earnings is deductible; the amount of the deductible portion depends upon whether the deferred earnings are held in cash or other assets. The deduction results in a reduced rate of tax with respect to income from the required inclusion of pre-effective date earnings. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The separate foreign tax credit limitation rules of present law section 904 apply, with coordinating rules. The increased tax liability generally may be paid over an eight-year period.

Subpart F

The mechanism for the mandatory inclusion of pre-effective-date foreign earnings is subpart F. The proposal provides that in the last taxable year of a specified foreign corporation that begins before January 1, 2018, which is that foreign corporation's last taxable year before the transition to the new corporate tax regime elsewhere in the bill goes into effect, the subpart F income of the foreign corporation is increased by no less than the accumulated deferred foreign income of the corporation, determined as of November 9, 2017, or other applicable measurement date as appropriate ("measurement date"). The transition rule applies to all U.S. shareholders[805] of a specified foreign corporation, which includes any foreign corporation in which a U.S. person owns 10 percent of the voting stock. Consistent with the general operation of subpart F, each U.S. shareholder of a specified foreign corporation must include in income the shareholder's pro rata share of the foreign corporation's subpart F income attributable to its mandatory inclusion.[806]

Accumulated deferred foreign income

A specified foreign corporation's accumulated deferred foreign income on the measurement date is based on all post-1986 foreign earnings and profits that are not previously taxed and not (1) attributable to income that is effectively connected with the conduct of a trade or business in the United States and subject to U.S. income tax or (2) subpart F income (determined without regard to the mandatory inclusion) of a CFC that is included in the gross income of a U.S. shareholder of the CFC. The potential pool of includible earnings includes all undistributed foreign earnings accumulated in taxable years beginning after 1986, computed in accordance with sections 964(a) and 986, taking into account only periods when the foreign corporation was a specified corporation. The pool of post-1986 foreign earnings and profits is not reduced by distributions during the taxable year to which section 965 applies.

The pool of post-1986 earnings and profits taken into consideration in computing the mandatory inclusion required of a U.S. shareholder under this transition rule generally may be reduced by foreign earnings and profits deficits that are properly allocated to that person by

[805] Sec. 951(b), which defines United States shareholder as any U.S. person that owns 10 percent or more of the voting classes of stock of a foreign corporation.

[806] For purposes of taking into account its subpart F income under this rule, a noncontrolled 10/50 corporation is treated as a CFC.

reason of that person's interest in one or more specified foreign corporations with a deficit in post-1986 foreign earnings and profits as of the measurement date.

The aggregate foreign E & P deficit is generally allocable to a specified foreign corporation in the same ratio as the U.S. shareholder's pro rata share of post-1986 deferred income in that corporation bears to the U.S. shareholder's pro rata share of accumulated post-1986 deferred foreign income from all specified foreign corporations with respect to which the shareholder is a U.S. shareholder.

Deduction from mandatory inclusion

U.S. shareholders with accumulated deferred foreign income may deduct a portion of the mandatory inclusion in an amount that depends upon the proportion of aggregate earnings and profits attributable to cash assets rather than noncash assets. A U.S. shareholder may deduct so much of the aggregate earnings and profits attributable to cash assets as is necessary to result in a tax rate of 10 percent for such inclusion. With respect to the remainder of the deferred income in the mandatory inclusion, the U.S. shareholder may deduct an amount sufficient to result in a tax rate of 5 percent with respect to such income.

The aggregate earnings and profits attributable to cash assets for a U.S. shareholder is the greater of the pro rata share of the cash position of all specified foreign corporations as of the last day of the taxable year of the mandatory inclusion, or the average of the cash position determined on the last day of each of the two taxable years ending immediately before the measurement date. Rules are provided to avoid double counting of cash assets.

Foreign tax credit

The portion of foreign income tax that is deemed paid or accrued with respect to the taxable portion of the mandatory inclusion is not creditable or deductible against the Federal income tax attributable to the inclusion. The disallowed portion of foreign tax credits is 71.4 percent of foreign taxes paid attributable to the portion of the section 965 inclusion attributable to the aggregate cash position plus, 85.7 percent of foreign taxes paid attributable to the remaining portion of the section 965 inclusion.[807] The proposal coordinates the disallowance of foreign tax credits with the requirement[808] that a domestic corporate shareholder is deemed to receive a dividend in an amount equal to foreign taxes it is deemed to have paid and for which it claimed a credit.

[807] Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full.

[808] Sec. 78.

Limitations on assessment extended

The proposal also provides an exception to the otherwise applicable limitations period for assessment of tax to ensure that the period for assessment of underpayments in tax related to the determination treatment of the mandatory inclusion (including related deductions and credits) does not expire prior to six years from the date on which the tax return initially reflecting the mandatory inclusion was filed.

Installment payments

A U.S. shareholder may elect to pay the net tax liability resulting from the mandatory inclusion of pre-effective-date undistributed CFC earnings in eight installments. If installment payment is elected, the payments for each of the first five years equals 8 percent of the net tax liability. The amount of the sixth installment is 15 percent of the net tax liability, increasing to 20 percent for the seventh installment and the remaining balance of 25 percent in the eighth year.

The net tax liability that may be paid in installments is the excess of the U.S. shareholder's net income tax for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income over the taxpayer's net income tax for that year determined without regard to the inclusion. Net income tax means net income tax as defined for purposes of the general business credit, but reduced by the amount of that credit.

An election to pay tax in installments must be made by the due date for the tax return for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income. The Treasury Secretary has authority to prescribe the manner of making the election. The first installment must be paid on the due date (determined without regard to extensions) for the tax return for the taxable year of the income inclusion. Succeeding installments must be paid annually no later than the due dates (without extensions) for the income tax return of each succeeding year. If a deficiency is later determined with respect to the net tax liability, the additional tax due may be prorated among all installment payments in most circumstances. The portions of the deficiency prorated to an installment that was due before the deficiency was assessed must be paid upon notice and demand. The portion prorated to any remaining installment is payable with the timely payment of that installment payment, unless the deficiency is attributable to negligence, intentional disregard of rules or regulations, or fraud with intent to evade tax, in which case the entire deficiency is payable upon notice and demand.

The timely payment of an installment does not incur interest. If a deficiency is determined that is attributable to an understatement of the net tax liability due under this proposal, the deficiency is payable with underpayment interest for the period beginning on the date on which the net tax liability would have been due, without regard to an election to pay in installments, and ending with the payment of the deficiency. Furthermore, any amount of deficiency prorated to a remaining installment also bears interest on the deficiency, but not on the original installment amount.

The proposal also includes an acceleration rule. If (1) there is a failure to pay timely any required installment, (2) there is a liquidation or sale of substantially all of the U.S. shareholder's assets (including in a bankruptcy case), (3) the U.S. shareholder ceases business, or (4) another

similar circumstance arises, the unpaid portion of all remaining installments is due on the date of the event (or, in a bankruptcy proceeding or similar case, the day before the petition is filed).

Special rule for S corporations

A special rule permits deferral of the transition net tax liability for shareholders of a U.S. shareholder that is an S corporation.[809] The S corporation is required to report on its income tax return the amount includible in gross income by reason of this provision, as well as the amount of deduction that would be allowable, and provide a copy of such information to its shareholders. Any shareholder of the S corporation may elect to defer the net tax liability until the shareholder's taxable year in which a triggering event occurs. The election to defer the tax is due not later than the due date for the return of the S corporation for its last taxable year that begins before January 1, 2018.

Three types of events may trigger an end to deferral of the net tax liability. The first type of triggering event is a change in the status of the corporation as an S corporation. The second category includes liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, including reorganization in bankruptcy. The third type of triggering event is a transfer of shares of stock in the S corporation by the electing taxpayer, whether by sale, death or otherwise, unless the transferee of the stock agrees with the Secretary to be liable for net tax liability in the same manner as the transferor. Partial transfers trigger the end of deferral only with respect to the portion of tax properly allocable to the portion of stock sold.

If a shareholder of an S corporation has elected deferral under the special rule for S corporation shareholders and a triggering event occurs, the S corporation and the electing shareholder are jointly and severally liable for any net tax liability and related interest or penalties. The period within which the IRS may collect such liability does not begin before the date of an event that triggers the end of the deferral. If an election to defer payment of the net tax liability is in effect for a shareholder, that shareholder must report the amount of the deferred net tax liability on each income tax return due during the period that the election is in effect. Failure to include that information with each income tax return will result in a penalty equal to five-percent of the amount that should have been reported.

After a triggering event occurs, a shareholder in the S corporation may elect to pay the net tax liability in eight installments, subject to rules similar to those generally applicable absent deferral. Whether or not a shareholder may elect to pay in installments depends upon the type of event that triggered the end of deferral. If the triggering event is liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, the installment payment election is not available. Instead, the entire net tax liability is due upon notice and demand. The installment election is due with the timely return for the year in which

[809] Section 1361 defines an S corporation as a domestic small business corporation that has an election in effect for status as an S corporation, with fewer than 100 shareholders, none of whom are nonresident aliens, and all of whom are individuals, estates, trusts or certain exempt organizations.

the triggering event occurs. The first installment payment is required by the due date of the same return, determined without regard to extensions of time to file.

Recapture from expatriated entities

The proposal denies any deduction claimed with respect to the mandatory subpart F inclusion and imposes a tax rate of 35-percent on the entire inclusion if a U.S. shareholder becomes an expatriated entity within the meaning of section 7874(a)(2) at any point within the ten-year period following enactment of this proposal. An entity that becomes a surrogate foreign corporation that is treated as a domestic corporation under section 7874(b) is not within the scope of this recapture proposal. Although the amount due is computed by reference to the year in which the deemed subpart F income was originally reported, the additional tax arises and is assessed for the taxable year in which the U.S. shareholder becomes an expatriated entity. No foreign tax credits are permitted with respect to the additional tax due as a result of the recapture rule. The Secretary is authorized to prescribe rules necessary to carry out the proposal.

Effective Date

The proposal is effective for the last taxable year of foreign corporations beginning before January 1, 2018, and all subsequent taxable years of a foreign corporation and for the taxable years of a U.S. shareholder with or within which such taxable years end.

B. Rules Related to Passive and Mobile Income

1. Current year inclusion of global intangible low-taxed income by United States shareholders

Description of Proposal

Under the proposal, a U.S. shareholder of any CFC must include in gross income for a taxable year its global intangible low-taxed income ("GILTI") in a manner generally similar to inclusions of subpart F income. GILTI means, with respect to any U.S. shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10 percent of the aggregate of the shareholder's pro rata share of the qualified business asset investment ("QBAI") of each CFC with respect to which it is a U.S. shareholder.

Net CFC tested income

Net CFC tested income means, with respect to any U.S. shareholder, the excess of the aggregate of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the tested loss of each CFC with respect to which it is a U.S. shareholder. Pro rata shares are determined under the rules of section 951(a)(2).

The tested income of a CFC means the excess (if any) of the gross income of the corporation determined without regard to certain exceptions to tested income: (1) the corporation's ECI under section 952(b); (2) any gross income taken into account in determining the corporation's subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income and foreign oil related income, over deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5).

The tested loss of a CFC means the excess (if any) of deductions (including taxes) properly allocable to the corporation's gross income determined without regard to the tested income exceptions over the amount of such gross income.

Qualified business asset investment

QBAI means, with respect to any CFC for a taxable year, the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under current section 168(g), notwithstanding any provision of law (or any other section of this bill) which is enacted after the date of enactment of this proposal.

Specified tangible property means any property used in the production of tested income or tested loss. If such property was used in the production of tested income and income that is not tested income, the property is treated as specified tangible property in the same proportion that the tested income produced with respect to the property bears to the total amount of gross income produced with respect to the property less deductions, including taxes, properly allocable to such gross income.

For purposes of determining QBAI, the Secretary is authorized to issue anti-avoidance regulations or other guidance as the Secretary determines appropriate, including regulations or other guidance that provide for the treatment of property if the property is transferred or held temporarily, or if avoidance was a factor in the transfer or holding of the property.

Coordination with subpart F

In general, GILTI amount included in gross income is treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4). However, the Secretary may provide rules for coordinating the GILTI inclusion with provisions of law in which the determination of subpart F income is required to be made at the CFC level.

The proposal requires that the amount of GILTI included by a U.S. shareholder be allocated across each CFC with respect to which it is a U.S. shareholder. The portion of GILTI treated as being with respect to a CFC equals zero for a CFC with no tested income and, for a CFC with tested income, the portion of GILTI which bears the same ratio to the total amount of GILTI as the U.S. shareholder's pro rata amount of tested income of the CFC bears to the aggregate amount of the U.S. shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder.

For purposes of the GILTI inclusion, a person is treated as a U.S. shareholder of a CFC for any taxable year only if such person owns (within the meaning of section 958(a)) stock in the corporation on the last day, in such year, on which the corporation is a controlled foreign corporation. A corporation is generally treated as a CFC for any taxable year if the corporation is a CFC at any time during the taxable year.

Deemed-paid credit for taxes properly attributable to tested income

For any amount of GILTI included in the gross income of a domestic corporation, the corporation is deemed to have paid foreign income taxes equal to 80 percent of the product of the corporation's inclusion percentage multiplied by the aggregate tested foreign income taxes paid or accrued, with respect to tested income, by each CFC with respect to which the domestic corporation is a U.S. shareholder.

The inclusion percentage means, with respect to any domestic corporation, the ratio (expressed as a percentage) of such corporation's GILTI amount divided by the aggregate amount of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder.

Tested foreign income taxes means, with respect to any domestic corporation that is a U.S. shareholder of a CFC, the foreign income taxes paid or accrued by the CFC that are properly attributable to the CFC's tested income.

The proposal creates a separate foreign tax credit basket for GILTI, with no carryforward or carryback available for excess credits. For purposes of determining the foreign tax credit limitation, GILTI is not general category income, and income that is both GILTI and passive category income is considered passive category income. The taxes deemed to have been paid are treated as an increase in GILTI for purposes of section 78, determined by taking into account 100 percent of the aggregate tested foreign income taxes.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Deduction for foreign-derived intangible income

Description of Proposal

In the case of a domestic corporation for its taxable year, the proposal allows a deduction equal to 37.5 percent of the lesser of (1) the sum of its foreign-derived intangible income plus the amount of GILTI that is included in its gross income, or (2) its taxable income, determined without regard to this proposal.[810] The foreign-derived intangible income of any domestic corporation is the amount which bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction eligible income. The Secretary is authorized to prescribe regulations or other guidance as may be necessary or appropriate to carry out this proposal.

Deduction eligible income

Deduction eligible income means, with respect to any domestic corporation, the gross income of the corporation determined without regard to: (1) the subpart F income of the corporation under section 951; (2) the GILTI of the corporation; (3) any dividend received from a CFC with respect to which the corporation is a U.S. shareholder; and (4) any domestic oil and gas income of the corporation; and (5) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation, over the deductions (including taxes) properly allocable to such gross income.

Deemed intangible income

The domestic corporation's deemed intangible income means the excess (if any) of its deduction eligible income over its deemed tangible income return. The deemed tangible income

[810] Global intangible low-income taxed income is defined in new sec. 951A.

return means, with respect to any corporation, an amount equal to 10 percent of the corporation's qualified business asset investment ("QBAI").

For purposes of computing its foreign-derived intangible income, a domestic corporation's QBAI is the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under section 168(g), notwithstanding any provision of law (or any other section of this bill) which is enacted after the date of enactment of this proposal.

Specified tangible property means any tangible property used in the production of deduction eligible income. If such property was used in the production of deduction eligible income and income that is not deduction eligible income, the property is treated as specified tangible property in the same proportion that the deduction eligible income produced with respect to the property, bears to the total amount gross income produced with respect to the property less deductions (including taxes) properly allocable to such gross income.

Foreign-derived deduction eligible income

Foreign-derived deduction eligible income means, with respect to a taxpayer for its taxable year, any deduction eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a United States person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States. Foreign use means any use, consumption, or disposition that is not within the United States. Special rules for determining foreign use apply to transactions that involve property or services provided to domestic intermediaries or related parties.

For purposes of the proposal, the terms "sold," "sells", and "sale" include any lease, exchange, or other disposition.

Property or services provided to domestic intermediaries

If a taxpayer sells property to another person (other than a related party) for further manufacture or modification within the United States, the property is not treated as sold for a foreign use even if such other person subsequently uses such property for foreign use. Income derived in connection with services provided to another person (other than a related party) located within the United States is not treated as foreign-derived deduction eligible income.

Special rules with respect to related party transactions

If property is sold to a related foreign party, the sale is not treated as for a foreign use unless the property is sold by the related foreign party to another person who is unrelated and is not a U.S. person and the taxpayer establishes to the satisfaction of the Secretary that such property is for a foreign use. Income derived in connection with services provided to a related party who is not located in the United States is not treated as foreign-derived deduction eligible

income unless the taxpayer establishes to the satisfaction of the Secretary that such service is not substantially similar to services provided by the related party to persons located within the United States.

For purposes of applying these rules, a related party means any member of an affiliated group as defined in section 1504(a) determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to sections 1504(b)(2) and 1504(b)(3). Any person (other than a corporation) is treated as a member of the affiliated group if the person is controlled by members of the group (including any entity treated as a member of the group by reason of this sentence) or controls any member, with control being determined under the rules of section 954(d)(3).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders

Description of Proposal

For certain distributions of intangible property held by a CFC on the date of enactment of this proposal, the fair market value of the property on the date of the distribution is treated as not exceeding the adjusted basis of the property immediately before the distribution. If the distribution is not a dividend, a U.S. shareholder's adjusted basis in the stock of the CFC with respect to which the distribution is made is increased by the amount (if any) of the distribution that would, but for this proposal, be includible in gross income. The adjusted basis of the property in the hands of the U.S. shareholder immediately after the distribution is the adjusted basis immediately before the distribution, reduced by the amount of the increase (if any) described previously.

For purposes of the proposal, intangible property means intangible property as described in section 936(h)(3)(B) and computer software as described in section 197(e)(3)(B).

The proposal applies to distributions that are (1) received by a domestic corporation from a CFC with respect to which it is a U.S. shareholder and (2) made by the CFC before the last day of the third taxable year of the CFC beginning after December 31, 2017.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

C. Other Modifications of Subpart F Provisions

1. Elimination of inclusion of foreign base company oil related income

Description of Proposal

The proposal eliminates foreign base company oil related income as a category of foreign base company income.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Inflation adjustment of *de minimis* exception for foreign base company income

Description of Proposal

In the case of any taxable year beginning after 2017, the proposal indexes for inflation the $1,000,000 *de minimis* amount for foreign base company income, with all increases rounded to the nearest multiple of $50,000.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

3. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment

Description of Proposal

The proposal repeals section 955. As a result, a U.S. shareholder in a CFC that invested its previously excluded subpart F income in qualified foreign base company shipping operations is no longer required to include in income a pro rata share of the previously excluded subpart F income when the CFC decreases such investments.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders within which or with which such taxable years of foreign corporations end.

4. Modification of stock attribution rules for determining status as a controlled foreign corporation

Description of Proposal

The proposal amends the ownership attribution rules of section 958(b) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, the proposal provides "downward attribution" from a foreign person to a related U.S. person in circumstances in which present law does not so provide. The pro rata share of a CFC's subpart F income that a United States shareholder is required to include in gross income, however, continues to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule.

Effective Date

The proposal is effective for the last taxable year of foreign corporations beginning before January 1, 2018 and all subsequent taxable years of a foreign corporation and for the taxable years of a U.S. shareholder with or with which such taxable years end.

5. Modification of definition of United States shareholder

Description of Proposal

This proposal expands the definition of U.S. shareholder under subpart F to include any U.S. person who owns 10 percent or more of the total value of shares of all classes of stock of a foreign corporation.

Effective Date

The proposal is effective for the last taxable year of foreign corporations beginning before January 1, 2018, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

6. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply

Description of Proposal

The proposal eliminates the requirement that a corporation must be controlled for an uninterrupted period of 30 days before subpart F inclusions apply.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

7. Look-thru rule for related controlled foreign corporations made permanent

Description of Proposal

The proposal makes permanent the exclusion from foreign personal holding company income for certain dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2019, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

8. Corporations eligible for deductions for dividends exempted from subpart F inclusions for increased investments in United States property

Description of Proposal

The requirement in subpart F that U.S. shareholders recognize income when earnings are repatriated in the form of increases in investment by a CFC in U.S. property is amended to provide an exception for domestic corporations that are U.S. shareholders in the CFC either directly or through a domestic partnership.

Effective Date

The proposal is effective for taxable years of controlled foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of the foreign corporations end.

D. Prevention of Base Erosion

1. Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness

Description of Proposal

The proposal addresses base erosion that results from excessive and disproportionate borrowing in the United States by limiting the deductibility of interest paid or accrued by U.S. corporations that are members of a worldwide affiliated group. For any domestic corporation that is a member of a worldwide affiliated group, the proposal reduces the deduction for interest paid or accrued by the corporation by the product of the net interest expense of the domestic corporation multiplied by the debt-to-equity differential percentage of the worldwide affiliated group. Net interest expense means the excess (if any) of: (1) interest paid or accrued by the taxpayer during the taxable year, over (2) the amount of interest includible in the gross income of the taxpayer for the taxable year.[811]

A worldwide affiliated group is one or more chains of corporations, connected through stock ownership with a common parent that would qualify as an affiliated group under section 1504, with two differences. First, the ownership threshold of section 1504(a)(2) is applied using 50 percent rather than 80 percent. Second, the restriction on inclusion of a foreign corporation under section 1504(b)(3) is disregarded for purposes of identifying the worldwide affiliated group.

The debt-to-equity differential percentage means, with respect to any worldwide affiliated group, the excess domestic indebtedness of the group divided by the total indebtedness of the domestic corporations that are members of the group. All U.S. members of the worldwide affiliated group are treated as one member when determining whether the group has excess domestic indebtedness as a result of a debt-to-equity differential. Excess domestic indebtedness is the amount by which the total indebtedness of the U.S. members exceeds 110 percent of the total indebtedness those members would hold if their total indebtedness to total equity ratio were proportionate to the ratio of total indebtedness to total equity in the worldwide group. Total equity means, with respect to one or more corporations, the excess (if any) of: (1) the money and all other assets of such corporations, over (2) the total indebtedness of such corporations. Intragroup debt and equity interests are disregarded for purposes of this computation.

The amount of any interest not allowed as a deduction for any taxable year by reason of this proposal or new section 163(j) (depending on whichever imposes the lower limitation with respect to such taxable year) can be carried forward indefinitely.

The Secretary is provided regulatory authority to provide rules for: (1) the prevention of the avoidance of this proposal, (2) the coordination of this proposal with section 884, (3) the

[811] The Secretary is provided is regulatory authority to provide for adjustments in determining the amount of net interest expense.

treatment of partnership indebtedness, allocation of partnership debt, interest, or distributive shares, and (4) the coordination of this proposal with section 163(j).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Limitations on income shifting through intangible property transfers

Description of Proposal

The proposal addresses recurring definitional and methodological issues that have arisen in controversies[812] in transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The proposal revises that definition and confirms the authority to require certain valuation methods. It does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.

Under the proposal, workforce in place, goodwill (both foreign and domestic), and going concern value are intangible property within the meaning of section 936(h)(3)(B), as is the residual category of "any similar item" the value of which is not attributable to tangible property or the services of an individual. The flush language at the end of that subparagraph is removed, to make clear that the source or amount of value is not relevant to whether property that is one of the specified types of intangible property is within the scope of the definition.

The proposal also clarifies the authority of the Commissioner to specify the method to be used to determine the value of intangible property, both with respect to outbound restructurings of U.S. operations and to intercompany pricing allocations.[813] First, in the case of transfers of multiple intangible properties in one or more related transactions, valuation of such intangible property on an aggregate basis is explicitly permitted if the Commissioner determines that an aggregate basis achieves a more reliable result than an asset-by-asset approach. The proposal is consistent with the position that the additional value that results from the interrelation of intangible assets can be properly attributed to the underlying intangible assets in the aggregate, where doing so yields a more reliable result. This approach is also consistent with Tax Court decisions in cases outside of the section 482 context, where collections of multiple, related

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[812] *Veritas v. Commissioner,* 133 T.C. No. 14 (December 10, 2009), *non-acq.*, IRB 2010-49 (December 6, 2010).

[813] Secs. 367(d) and 482.

intangible assets were viewed by the Tax Court in the aggregate.[814] Finally, it is also consistent with the cost-sharing regulations.[815]

The proposal also codifies the realistic alternative principle with respect to intangible property. The realistic alternative principle is predicated on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration. As a result, the existing regulations provide the IRS with the ability to determine an arm's-length price by reference to a transaction (such as the owner of intangible property using it to make a product itself) that is different from the transaction that was actually completed (such as the owner of that same intangible property licensing the manufacturing rights and then buying the product from the licensee).

Effective Date

The proposal applies to transfers in taxable years beginning after December 31, 2017. No inference is intended with respect to application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application on or before the date of enactment.

3. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities

Description of Proposal

The proposal denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under section 951(a). A related party for these purposes is determined under the rules of section 954(d)(3), except that such section applies with respect to the payor as opposed to the CFC on otherwise referred to in such section.

[814] See, *e.g.*, *Kraft Foods Co. v. Commissioner*, 21 T.C. 513 (1954) (thirty-one related patents must be valued as a group and the useful life for depreciation should be based on the average of the patents' useful lives); *Standard Conveyor Co. v. Commissioner*, 25 B.T.A. 281, p. 283 (1932) ("[I]t is evident that it is impossible to value these seven patents separately. Their value, as in the case of many groups of patents representing improvements on the prior art, appears largely to consist of their combination."); *Massey-Ferguson, Inc. v. Commissioner*, 59 T.C. 220 (1972) (taxpayer who abandoned a distribution network of contracts with separate distributorships was entitled to an abandonment loss for the entire network in the taxable year during which the last of the contracts was terminated because that was the year in which the entire intangible value was lost).

[815] See Treas. Reg. sec. 1.482-7(g)(2)(iv) (if multiple transactions in connection with a cost-sharing arrangement involve platform, operating and other contributions of resources, capabilities or rights that are reasonably anticipated to be interrelated, then determination of the arm's-length charge for platform contribution transactions and other transactions on an aggregate basis may provide the most reliable measure of an arm's-length result).

A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for Federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax. A hybrid entity is any entity which is either: (1) treated as fiscally transparent for Federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for Federal income tax purposes.

The proposal grants the Secretary authority to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the proposal, including regulations or other guidance providing rules for: (1) denying deductions for conduit arrangements that involve a hybrid transaction or a hybrid entity, (2) the application of this proposal to foreign branches, (3) applying this proposal to certain structured transactions, (4) denying all or a portion of a deduction claimed for an interest or a royalty payment that, as a result of the hybrid transaction or entity, is included in the recipient's income under a preferential tax regime of the country of residence of the recipient and has the effect of reducing the country's generally applicable statutory tax rate by at least 25 percent, (5) denying all of a deduction claimed for an interest or a royalty payment if such amount is subject to a participation exemption system or other system which provides for the exclusion of a substantial portion of such amount, (6) rules for determining the tax residence of a foreign entity, and (7) exceptions to the general rule set forth in the proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Termination of special rules for domestic international sales corporations

Description of Proposal

The proposal repeals the special Code rules for DISCs and IC-DISCs.

In particular, the proposal terminates any corporate election to be treated as a DISC that is in effect for the corporation's last taxable year beginning in 2018. The termination is effective for the corporation's immediately succeeding taxable year (and all years thereafter). The proposal also prohibits any new corporate election to be treated as a DISC for any taxable year beginning after December 31, 2018.

As a result of the proposal's termination of existing corporate DISC elections and its prohibition of new DISC elections, the special rules that apply to DISCs, IC-DISCs and their shareholders will no longer have effect. In particular, corporations will no longer be permitted the exemption from corporate level tax allowed under the DISC rules, and individual shareholders of corporations for which DISC elections are terminated will be subject to shareholder-level taxation in respect of the earnings of the corporations in which they are shareholders under all the normal rules for shareholder-level taxation of corporate earnings.

The proposal includes a transition rule for shareholders of corporations the DISC elections of which are terminated. Under this transition rule, a shareholder of a corporation whose DISC election is terminated is deemed to have received, in the first taxable year for which the termination is effective, a distribution to which the section 995(b)(2) deemed distribution rules apply. The proposal provides that this deemed distribution – and any actual distribution after termination of the DISC election to the extent paid out of the corporation's accumulated DISC income – is not a qualifying dividend under section 1(h)(11)(B). Consequently, an individual DISC shareholder is not eligible for the preferential tax rate allowed under section 1(h)(11) with respect to such distributions.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2018.

5. Surrogate foreign corporations not eligible for reduced rate on dividends

Description of Proposal

Any individual shareholder who receives a dividend from a corporation which is a surrogate foreign corporation as defined in section 7874(a)(2)(B), other than a foreign corporation which is treated as a domestic corporation under section 7874(b), is not entitled to the lower rates on qualified dividends provided for in section 1(h).

Effective Date

The proposal is effective for dividends paid in taxable years beginning after December 31, 2017.

E. Modifications Related to Foreign Tax Credit System

1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis

Description of Proposal

The proposal repeals the deemed-paid credit with respect to dividends received by a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation.

A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion. Foreign income taxes under the proposal include income, war profits, or excess profits taxes paid or accrued by the CFC to any foreign country or possession of the United States. The proposal eliminates the need for computing and tracking cumulative tax pools.

Additionally, the proposal provides rules applicable to foreign taxes attributable to distributions from previously taxed earnings and profits, including distributions made through tiered-CFCs.

The Secretary is granted authority under the proposal to provide regulations and other guidance as may be necessary and appropriate to carry out the purposes of this proposal. It is anticipated that the Secretary would provide regulations with rules for allocating taxes similar to rules in place for purposes of determining the allocation of taxes to specific foreign tax credit baskets.[816] Under such rules, taxes are not attributable to an item of subpart F income if the base upon which the tax was imposed does not include the item of subpart F income. For example, if foreign law exempts a certain type of income from its tax base, no deemed-paid credit results from the inclusion of such income as subpart F. Tax imposed on income that is not included in subpart F income, is not considered attributable to subpart F income.

In addition to the rules described in this section, the proposal makes several conforming amendments to various other sections of the Code reflecting the repeal of section 902 and the modification of section 960. These conforming amendments include amending the section 78 gross-up provision to apply solely to taxes deemed paid under the amended section 960.

Effective Date

The proposal is effective for taxable years of foreign corporation beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

[816] See Treas. Reg. sec. 1.904-6(a).

2. Separate foreign tax credit limitation basket for foreign branch income

Description of Proposal

The proposal requires foreign branch income to be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a U.S. person which are attributable to one or more QBUs in one or more foreign countries.

Under this proposal, business profits of a QBU shall be determined under rules established by the Secretary. Business profits of a QBU shall not, however, include any income which is passive category income.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

3. Acceleration of election to allocate interest, etc., on a worldwide basis

Description of Proposal

This proposal accelerates the effective date of the worldwide interest allocation rules to apply to taxable years beginning after December 31, 2017, rather than to taxable years beginning after December 31, 2020.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

4. Source of income from sales of inventory determined solely on basis of production activities

Description of Proposal

Under this proposal, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States is allocated and apportioned on the basis of the location of production with respect to the property. For example, income derived from the sale of inventory property to a foreign jurisdiction is sourced wholly within the United States if the property was produced entirely in the United States, even if title passage occurred elsewhere. Likewise, income derived from inventory property sold in the United States, but produced entirely in another country, is sourced in that country even if title passage occurs in the United States. If the inventory property is produced partly in, and partly outside, the United States, however, the income derived from its sale is sourced partly in the United States.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

F. Inbound Provisions

1. Base erosion and anti-abuse tax

Description of Proposal

Tax on base erosion payments

Under the proposal, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount means, with respect to an applicable taxpayer for any taxable year, the excess of 10-percent of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess (if any) of credits allowed under Chapter 1 over the credit allowed under section 38 (general business credits) for the taxable year allocable to the research credit under section 41(a).

Modified taxable income means the taxable income of the taxpayer computed under Chapter 1 for the taxable year, determined without regard to any base erosion tax benefit with respect to any base erosion payment, or the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year.

A base erosion payment generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). A base erosion payment also includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2), but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

A base erosion tax benefit means any deduction allowed with respect to a base erosion payment for the taxable year.

Any base erosion tax benefit attributable to any base erosion payment on which tax is imposed by sections 871 or 881 and with respect to which tax has been deducted and withheld under sections 1441 or 1442, is not taken into account in computing modified taxable income as defined above. If the rate of tax required to be deducted and withheld under sections 1441 or 1442 with respect to any base erosion payment is reduced, the above exclusion only applies in proportion to such reduction.

The base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year by the aggregate amount of the deductions allowable to the taxpayer under Chapter 1 for the taxable year, taking into account base erosion tax benefit for which a deduction is allowed under Chapter

1 and by not taking into account any deduction allowed under sections 172, 245A or 250 for the taxable year.

An applicable taxpayer means, with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) which has average annual gross receipts of at least $500 million for the three-taxable-year period ending with the preceding taxable year; and (C) which has a base erosion percentage of four percent or higher for the taxable year.

In the case of a foreign person the gross receipts of which are taken into account for purposes of this proposal, only gross receipts which are taken into account in determining income effectively connected with the conduct of a trade or business within the United States is taken into account for these purposes. If a foreign person's gross receipts are aggregated with a U.S. person's gross receipts for reasons described below (on aggregation rules), the preceding sentence does not apply to the gross receipts of any U.S. person which are aggregated with the taxpayer's gross receipts.

All persons treated as a single employer under section 52(a) are treated as one person for purposes of this proposal, except that in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) is disregarded.

For purposes of this proposal, foreign person has the meaning given in section 6038A(c)(3).

Related party means: (i) any 25-percent owner of the taxpayer, (ii) any person who is related to the taxpayer or any 25-percent owner of the taxpayer, within the meaning of sections 267(b) or 707(b)(1), and (iii) any other person related to the taxpayer within the meaning of section 482. For these purposes, section 318 regarding constructive ownership of stock applies to these related party rules except that that "10 percent" is substituted for "50 percent" in section 318(a)(2)(C), and for these purposes sections 318(a)(3)(A), (B) and (C) do not cause a U.S. person to own stock owned by a person who is not a U.S. person.

The proposal introduces additional reporting requirements under section 6038A. The Secretary of the Treasury may prescribe regulations with regard to information relating to: (A) the name, principal place of business, and country or countries in which each person is organized or resident which: (i) is a related party to the reporting corporation, and (ii) had a transaction with the reporting corporation during its taxable year, (B) the manner of relation between the reporting corporation and the person referred to in (A), and (C) transactions between the reporting corporation and each related foreign person.

In addition, for purposes of information reporting under sections 6038A and 6038C, if the reporting corporation or the foreign corporation to which section 6038C applies is an applicable taxpayer under this proposal, the information that may be required includes: (A) base erosion payments paid or accrued during the taxable year by the taxpayer to a foreign person which is a related party of the taxpayer, (B) such information as the Secretary of the Treasury finds necessary to determine the base erosion minimum tax amount of the taxpayer for the taxable year, and (C) such other information as the Secretary of the Treasury determines is necessary.

The penalties provided for under sections 6038A(D)(1) and (2) are both increased to $25,000.

Effective Date

The proposal applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

G. Other Provisions

1. Taxation of passenger cruise gross income of foreign corporations and nonresident alien individuals

Description of Proposal

The proposal creates a category of income defined as passenger cruise gross income, provides specific rules for determining the extent to which such income is effectively connected with the conduct of a trade or business in the United States, and removes such income from eligibility for the reciprocal exemptions of sections 873 and 883. As a result, effectively connected passenger cruise income is subject to net basis taxation. A conforming amendment to the definition of effectively connected income for purposes of the gross basis tax on international shipping income is made.

Passenger cruise gross income is all income from the operation of a commercial vessel on a covered voyage. A covered voyage is generally defined in as a voyage that would be subject to the passenger tax. An antiabuse provision is included such that if passengers embark a ship in the United States and more than 10 percent of the passengers disembark in the United States, the operation of the ship at all times between such events is treated as a covered voyage. A cruise in which all persons who embark in the United States later disembark in a foreign port, with no intervening stops, is a covered voyage.

In determining whether income is from the operation of a passenger cruise, one includes all income from actions incidental to the operation, as well as any amounts received with respect to any on- or off-board activities, services or sales with respect to passengers, whether or not the activities, sales or services are provided onboard the vessel. This includes any income from any agreement with any person with respect to the provision of the activities, services, or sales.

To determine what portion of passenger cruise gross income is effectively connected, the proposal requires a computation of the length (measured in calendar days) of the covered voyage and the portion of the voyage that occurs in U.S. territorial waters, defined as 12 nautical miles from low tide on the U.S. coastline or within the international boundary between the United States and a contiguous country. The time that the vessel is considered to be in U.S. territorial waters is compared to the total time of the voyage to arrive at the U.S. territorial waters percentage of the gross income. For purposes of this computation, any vessel in a U.S. port or within U.S. waters for any portion of a calendar day is considered to be in U.S. waters for an entire calendar day. Days during which a ship is out of service in a U.S. port for major repairs are not counted. In addition, under no circumstances is a single calendar day to be counted twice. Thus, a ship that leaves one U.S. port, exits U.S. waters and later the same calendar day again enters U.S. waters is in U.S. waters only one day.

The proposal explicitly requires that any income considered to be effectively connected under general rules without regard to the U.S. territorial percentage continues to be treated as such, even if the U.S. territorial percentage of passenger gross income is a lesser amount.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

2. Modification of insurance exception to the passive foreign investment company rules

Description of Proposal

The proposal modifies the requirements for a corporation the income of which is not included in passive income for purposes of the PFIC rules. The proposal replaces the test based on whether a corporation is predominantly engaged in an insurance business with a test based on the corporation's insurance liabilities. The requirement that the foreign corporation would be subject to tax under subchapter L if it were a domestic corporation is retained.

Under the proposal, passive income for purposes of the PFIC rules does not include income derived in the active conduct of an insurance business by a corporation (1) that would be subject to tax under subchapter L if it were a domestic corporation; and (2) the applicable insurance liabilities of which constitute more than 25 percent of its total assets as reported on the company's applicable financial statement for the last year ending with or within the taxable year.

For the purpose of the proposal's exception from passive income, applicable insurance liabilities means, with respect to any property and casualty or life insurance business (1) loss and loss adjustment expenses, (2) reserves (other than deficiency, contingency, or unearned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks. This includes loss reserves for property and casualty, life, and health insurance contracts and annuity contracts. Unearned premium reserves with respect to any type of risk are not treated as applicable insurance liabilities for purposes of the proposal. For purposes of the proposal, the amount of any applicable insurance liability may not exceed the lesser of such amount (1) as reported to the applicable insurance regulatory body in the applicable financial statement (or, if less, the amount required by applicable law or regulation), or (2) as determined under regulations prescribed by the Secretary.

An applicable financial statement is a statement for financial reporting purposes that (1) is made on the basis of generally accepted accounting principles, (2) is made on the basis of international financial reporting standards, but only if there is no statement made on the basis of generally accepted accounting principles, or (3) except as otherwise provided by the Secretary in regulations, is the annual statement required to be filed with the applicable insurance regulatory body, but only if there is no statement made on either of the foregoing bases. Unless otherwise provided in regulations, it is intended that generally accepted accounting principles means U.S. GAAP.

The applicable insurance regulatory body means, with respect to any insurance business, the entity established by law to license, authorize, or regulate such insurance business and to which the applicable financial statement is provided. For example, in the United States, the applicable insurance regulatory body is the State insurance regulator to which the corporation provides its annual statement.

If a corporation fails to qualify solely because its applicable insurance liabilities constitute 25 percent or less of its total assets, a United States person who owns stock of the corporation may elect in such manner as the Secretary prescribes to treat the stock as stock of a qualifying insurance corporation if (1) the corporation's applicable insurance liabilities constitute at least 10 percent of its total assets, and (2) based on the applicable facts and circumstances, the corporation is predominantly engaged in an insurance business, and its failure to qualify under the 25 percent threshold is due solely to specified circumstances involving such insurance business. Specified circumstances include, for example, the fact that the company is in runoff, that is, it is not taking on new insurance business (and consequently has little or no premium income), and is using its remaining assets to pay off claims with respect to pre-existing insurance risks on its books.

Effective Date

The proposal applies to taxable years beginning after December 31, 2017.

3. Repeal of fair market value of interest expense apportionment

Description of Proposal

The proposal prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of section 864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2017.

JOINT COMMITTEE ON TAXATION
November 9, 2017
JCX-52-17

TREAS-17-0313-I-000658

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
I. Tax Reform for Individuals													
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions													
1. 10%, 12%, 22.5%, 25%, 32.5, 35%, and 38.5% income tax rate brackets [1][2]........	tyba 12/31/17	-81.0	-117.8	-122.7	-127.4	-132.3	-137.5	-142.8	-148.6	-154.9	-161.0	-581.1	-1,325.9
2. Modify standard deduction ($12,000 for singles, $24,000 for married filing jointly, $18,000 for HoH) [2].....	tyba 12/31/17	-58.3	-84.1	-86.6	-89.7	-92.6	-95.1	-98.1	-101.6	-105.3	-108.4	-411.2	-919.8
3. Repeal of deduction for personal exemptions [2]................	tyba 12/31/17	96.4	141.8	146.4	151.4	157.2	163.2	169.2	175.3	181.7	188.2	693.2	1,570.9
4. Alternative inflation measure [2]..	tyba 12/31/17	0.9	2.3	5.7	8.5	10.7	13.2	17.1	20.6	23.7	28.3	28.3	131.2
B. Treatment of Business Income of Individuals													
1. Allow 17.4% deduction to certain domestic non-service passthrough income with exception for service passthrough income to taxpayers with taxable income below $150,000 for joint filers, $75,000 for all others, phased out over next $50,000 for joint filers, $25,000 for all others, indexed with $50 round-down rule; includes restriction based on allocated wages [3]..	tyba 12/31/17	-25.5	-43.1	-45.3	-46.5	-47.2	-46.2	-47.1	-50.1	-53.1	-56.0	-207.3	-459.7
2. Disallow active pass-through losses in excess of $500,000 for joint filers, $250,000 for all others.................	tyba 12/31/17	10.2	16.5	16.6	17.2	17.8	18.2	18.8	19.5	20.0	20.6	78.4	175.6
C. Reform of the Child Tax Credit													
1. Modification of child tax credit ($1,650 not indexed; refundable up to $1,000 indexed up to nearest $100 base year 2017; $2,500 refundability threshold not indexed; $500 other dependents not indexed; phaseouts $500,000/$1 Million not indexed; increase eligibility to less than 18 years old) [2]................................	tyba 12/31/17	-26.4	-55.5	-57.0	-58.2	-59.4	-62.2	-63.5	-64.7	-66.1	-68.8	-256.4	-58[illegible].8
2. Require valid Social Security number of each child to claim refundable portion of child credit [2].........................	tyba 12/31/17	---	2.9	2.8	2.7	2.6	2.7	2.6	2.5	2.6	2.7	11.1	24.1

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
D. Simplification and Reform of Deductions and Exclusions													
1. Repeal of itemized deductions for taxes not paid or accrued in a trade or business, interest on home equity debt, non-disaster casualty losses, tax preparation expenses, and certain miscellaneous expenses [2]	tyba 12/31/17	60.5	108.0	112.3	119.0	125.5	132.6	140.2	147.9	155.8	164.2	525.4	1,266.0
2. Increase percentage limit for charitable contributions of cash to public charities	cmi tyba 12/31/17	Estimate Included in Item I.D.1.											
3. Repeal of overall limitation on itemized deductions	tyba 12/31/17	Estimate Included in Item I.D.1.											
4. Modify exclusion of gain from sale of a principal residence	saea 12/31/17	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.4	1.1
5. Repeal exclusion for employer-provided bicycle commuter fringe benefit	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
6. Repeal exclusion for employer-provided qualified moving expense reimbursements [5][6]	tyba 12/31/17	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	2.7	6.1
7. Repeal of deduction for moving expenses (other than members of the Armed Forces)	tyba 12/31/17	0.6	0.8	0.9	0.9	1.0	1.0	1.1	1.1	1.2	1.2	4.2	9.7
8. Modification to wagering losses	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.1
E. Double Estate, Gift and GST Tax Exemption Amount	dda & gma 12/31/17	-1.2	-8.1	-8.8	-9.1	-9.6	-10.1	-10.7	-11.4	-12.1	-12.8	-36.8	-93.8
F. Repeal of Alternative Minimum Tax on Individuals	tyba 12/31/17	-6.1	-74.3	-65.2	-68.7	-72.5	-75.9	-79.7	-83.9	-88.0	-92.3	-286.9	-706.7
Total of Tax Reform for Individuals		**-29.5**	**-109.9**	**-100.2**	**-99.2**	**-98.1**	**-95.4**	**-92.2**	**-92.6**	**-93.7**	**-93.2**	**-435.9**	**-902.9**
II. Business Tax Reform													
A. Tax Rates													
1. 20% corporate tax rate in 2019 and thereafter	tyba 12/31/18	-15.2	-99.0	-138.6	-141.9	-143.2	-147.7	-152.5	-157.0	-163.1	-171.0	-537.9	-1,329.2
2. Reduction of dividends received deduction percentages	tyba 12/31/18	---	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	2.0	5.1
B. Repeal of Alternative Minimum Tax on Corporations [2]	tyba 12/31/17	-15.3	-8.3	-4.5	-4.7	-1.3	-1.3	-1.3	-1.3	-1.2	-1.1	-34.0	-40.3
C. Small Business Reforms													
1. Increase section 179 expensing to $1 million with a phaseout range beginning at $2.5 million and expand definition of qualified property	ppisi tyba 12/31/17	-3.5	-6.3	-4.3	-2.6	-2.0	-1.5	-1.1	-0.9	-0.9	-0.8	-18.8	-24.0
2. Simplified accounting for small business	[7]	-8.7	-6.9	-2.6	-1.6	-1.3	-1.2	-1.2	-1.3	-1.4	-1.4	-21.1	-27.6
D. Cost Recovery, etc.													
1. Limit net interest deductions to 30% of adjusted taxable income, carryforward of denied deduction	tyba 12/31/17	24.6	39.2	30.6	30.4	29.2	28.7	28.4	30.4	32.8	34.2	154.0	308.3
2. Provide 100% bonus depreciation for five years [8]	ppisa & sppoga 9/27/17	-36.2	-40.4	-23.3	-13.4	-11.0	8.8	22.3	14.9	10.6	6.4	-124.3	-61.3
3. Modifications to depreciation limitations on luxury automobiles and personal use property	ppisa 12/31/17	Estimate Included in Item II.D.2.											
4. Modifications of treatment of certain farm property	ppisa 12/31/17	[9]	[9]	[9]	-0.1	-0.2	-0.3	-0.2	-0.1	[9]	[9]	-0.4	-1.1
5. Modification of net operating loss deduction	lai tyba 12/31/17	14.8	14.4	11.3	15.6	23.9	30.7	28.8	19.4	9.1	2.5	79.8	170.4
6. Repeal like-kind exchanges except for real property	generally eca 12/31/17	0.6	1.0	1.3	1.8	2.3	2.9	3.7	4.5	5.6	6.7	7.0	30.5

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
7. Applicable recovery period for real property [10]................	ppisa 12/31/17	-0.3	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-2.7	-5.7
E. Business-Related Deductions													
1. Repeal of deduction for income attributable to domestic production activities..	tyba 12/31/18	-0.3	3.4	7.9	8.7	9.1	9.5	10.0	10.3	10.5	11.5	28.8	80.7
2. Limitation on deduction by employers of expenses for fringe benefits:													
a. Meals and entertainment expenses [11]..........................	apoia 12/31/17	1.6	2.0	2.1	2.1	2.2	2.3	2.4	2.5	2.6	2.6	10.0	22.4
b. Qualified transportation fringes [12]..............................	apoia 12/31/17	1.3	1.5	1.7	1.7	1.8	1.8	1.8	1.9	1.9	2.0	7.9	17.4
F. Accounting Methods													
1. Certain special rules for taxable year of inclusion (in general)...	tyba 12/31/17	1.9	2.0	1.6	1.6	0.6	0.2	0.2	0.2	0.2	0.2	7.8	8.9
2. Certain special rules for taxable year of inclusion (related to original issue discount)..	tyba 12/31/17	1.3	2.1	1.5	1.5	0.9	0.2	0.2	0.3	0.3	0.3	7.4	8.7
G. Business Credits													
1. Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions.........................	apoii tyba 12/31/17	0.5	1.4	1.8	2.2	2.6	3.1	3.7	4.2	4.8	5.3	8.6	29.7
2. Modification of rehabilitation credit....................................	[13]	[4]	0.2	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6	1.5	4.3
3. Repeal of deduction for certain unused business credits.......	tyba 12/31/17	*Negligible Revenue Effect*											
H. Banks and Financial Instruments													
1. Limitation on deduction for FDIC premiums........................	tyba 12/31/17	0.8	1.8	1.4	1.4	1.4	1.5	1.5	1.5	1.6	1.6	6.8	14.5
2. Repeal of advance refunding bonds.....................................	ar bia 12/31/17	0.4	1.1	1.4	1.7	1.9	2.0	2.0	2.1	2.1	2.1	6.5	16.8
3. Cost basis of specified securities determined without regard to identification...	seaoda 12/31/17	0.3	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.3	0.3	1.5	2.7
I. Compensation													
1. Nonqualified deferred compensation...................................	[14]	0.3	1.0	1.6	1.5	1.3	1.1	0.8	0.6	4.0	1.3	5.8	13.4
2. Modification of limitation on excessive employee remuneration...	tyba 12/31/17	0.3	2.0	1.2	1.1	1.1	1.0	1.0	1.0	0.9	0.8	5.7	10.4
3. 20% excise tax on excess tax-exempt organization executive compensation...	tyba 12/31/17	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	1.7	3.6
J. Insurance													
1. Net operating losses of life insurance companies..................	tyba 12/31/17	*Estimate Included in Item II.D.5*											
2. Repeal of small life insurance company deduction..............	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.2
3. Adjustment for change in computing reserves......................	tyba 12/31/17	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.6	1.3
4. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account.......................	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
5. Modification of proration rules for property and casualty insurance companies...	tyba 12/31/17	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.1	2.2
6. Repeal of special estimated tax payments............................	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
7. Capitalization of certain policy acquisition expenses...........	tyba 12/31/17	0.4	1.5	2.1	2.2	2.4	2.5	2.7	2.9	3.1	3.2	8.6	23.0
8. Tax reporting for life settlement transactions........................	generally tyba 12/31/17	[9]	[9]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.1	[4]	0.2
9. Clarification of tax basis of life insurance contracts.............	generally teia 8/25/09	*Estimate Included in Item II.J.8.*											
10. Exception to transfer for valuable consideration rules..........	ta 12/31/17	*Estimate Included in Item II.J.8.*											

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
K. Partnerships													
1. Tax gain on the sale of a partnership interest on look-thru basis	saea 12/31/17	[4]	0.2	0.3	0.3	0.4	0.5	0.5	0.5	0.5	0.6	1.2	3.8
2. Expand the definition of substantial built-in loss for purposes of partnership loss transfers	topia 12/31/17	[4]	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss	tyba 12/31/17	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.5	1.2
L. Determination of Worker Classification and Information Reporting Requirements													
1. Worker classification safe harbor and withholding [15]	[16]	-0.1	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-1.3	-3.4
2. Change in information reporting thresholds [2] [17]	pma 12/31/18	---	0.2	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	1.3	3.6
M. Tax-Exempt Organizations													
1. Excise tax based on investment income of private colleges and universities	tyba 12/31/17	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	1.2	2.5
2. Name and logo royalties treated as unrelated business taxable income	tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.8	2.0
3. Unrelated business taxable income separately computed for each trade or business activity	generally tyba 12/31/17	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	1.6	3.2
4. Repeal tax-exempt status for professional sports leagues	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1
5. Modification of taxes on excess benefit transactions (intermediate sanctions)	tyba 12/31/17	*Negligible Revenue Effect*											
6. Charitable deduction not allowed for amounts paid in exchange for college athletic event seating rights	cmi tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.9
N. Retirement Savings													
1. Conformity of contribution limits for employer-sponsored plans	pyba & tyba 12/31/17	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.7	1.7
2. Application of 10% early withdrawal tax to governmental 457 plans	tyba 12/31/17	[9]	-0.1	-0.1	-0.1	[9]	[9]	[9]	[9]	[9]	[9]	0.2	-0.3
3. Eliminate catch-up contributions for high-wage employees	pyba & tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	0.1	0.1	0.1	0.1	0.1	0.2	0.5
Total of Business Tax Reform		**-29.0**	**-84.2**	**-103.0**	**-88.0**	**-75.1**	**-52.2**	**-43.3**	**-60.4**	**-72.8**	**-89.5**	**-378.5**	**-697.2**
III. International Tax Reform													
A. Establishment of Participation Exemption System for Taxation of Foreign Income													
1. Deduction for dividends received by domestic corporations from certain foreign corporations	[18]	-17.7	-26.4	-18.3	-20.1	-20.5	-20.4	-21.7	-22.7	-23.4	-24.5	-103.0	-215.6
2. Special rules relating to sales or transfers involving certain foreign corporations	dri tyba & Ta 12/31/17	0.2	0.2	0.5	0.8	1.2	1.4	1.6	1.5	1.7	2.2	2.9	11.3

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
3. Treatment of deferred foreign income upon transition to participation exemption system of taxation and mandatory inclusion at two-tier rate (5-percent rate for illiquid assets, 10-percent rate for liquid assets).............	[19]	45.8	22.7	6.9	7.3	8.1	16.3	30.1	41.6	19.1	-8.0	90.9	190.0
B. Rules Related to Passive and Mobile Income													
1. Current year inclusion of global intangible low-taxed income, with deduction, by United States shareholders........	[18]	19.6	24.5	9.6	9.3	8.9	8.5	8.8	8.9	8.9	8.4	72.0	115.5
2. Deduction for foreign-derived intangible income derived from trade or business within the United States...................	tyba 12/31/17	-1.3	3.7	6.8	6.4	0.3	-11.4	-15.8	-19.9	-24.6	-30.6	15.9	-86.4
3. Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders..	[20]	-3.9	-7.3	-8.9	-12.1	-8.3	-0.9	1.7	1.8	1.9	1.9	-40.6	-34.1
C. Other Modifications of Subpart F Provisions													
1. Elimination of inclusion of foreign base company oil related income..	[18]	-0.1	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.6	-1.4	-4.0
2. Inflation adjustment of de minimis exception for foreign base company income...	[18]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	-0.2	-0.4
3. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment.........	[18]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]
4. Modification of stock attribution rules for determining status as a controlled foreign corporation.............................	[19]	- - - - - - - - - -	- - - - -	- - - - -	- - - - -	- - - - -	*Estimate Included in Item III.A.1.*	- - - - -	- - - - -	- - - - -	- - - - -	- - - - -	- - - - -
5. Modification of definition of United States shareholder.......	[18]	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.8	1.4
6. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply...	[18]	[4]	0.1	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.2	0.4
7. Look-thru rule for controlled foreign corporations made permanent...	[21]	---	---	-0.8	-1.2	-1.3	-1.4	-1.5	-1.7	-1.8	-2.0	-3.3	-11.8
8. Corporations eligible for deduction for dividends from controlled foreign corporations exempt from subpart F to investments in United States property..................................	[18]	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0	-2.0
D. Prevention of Base Erosion													
1. Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness...........................	tyba 12/31/17	0.5	0.8	0.7	0.8	0.7	0.9	1.0	0.9	1.2	1.3	3.5	8.8
2. Limitation on income shifting through intangible property transfers..	Ta tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.3
3. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities...........................	tyba 12/31/17	- - - - - - - - - -	- - - - -	- - - - -	- - - - -	- - - - -	*Estimate Included in Item III.A.1.*	- - - - -	- - - - -	- - - - -	- - - - -	- - - - -	- - - - -
4. Termination of special rules for domestic international sales corporation..	tyba 12/31/18	---	0.3	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.7	2.0	5.3
5. Surrogate foreign corporations not eligible for reduced rate on dividends...	dpa 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.7

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
E. Modifications Related to Foreign Tax Credit System													
1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis	[18]	*Estimate Included in Item III.A.1.*											
2. Separate foreign tax credit limitation basket for foreign branch income	tyba 12/31/17	*Estimate Included in Item III.B.1.*											
3. Acceleration of election to allocate interest, etc., on a worldwide basis	tyba 12/31/17	-0.3	-0.6	-0.7	-0.4	---	---	---	---	---	---	-2.0	-2.0
4. Source of income from sales of inventory determined solely on basis of production activities	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.5
F. Inbound Provisions													
1. Base erosion and anti-abuse tax	apoaa 12/31/17	3.9	9.3	11.5	12.1	12.6	13.4	14.2	14.7	15.4	16.6	49.3	123.5
G. Other Provisions													
1. Taxation of passenger cruise gross income of foreign corporations and nonresident alien individuals	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.7
2. Restriction on insurance business exception to passive foreign investment company rules	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.1
3. Repeal of fair market value method of interest expense apportionment	tyba 12/31/17	[4]	0.1	0.1	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.2	0.2
Total of International Tax Reform		**47.3**	**27.5**	**7.9**	**3.6**	**2.3**	**7.0**	**19.0**	**25.9**	**-0.8**	**-34.0**	**88.2**	**104.4**
NET TOTAL		**-11.2**	**-166.6**	**-195.3**	**-183.6**	**-170.9**	**-140.6**	**-116.5**	**-127.1**	**-167.3**	**-216.7**	**-726.2**	**-1,495.7**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be December 1, 2017.

Legend for "Effective" column:

apoia = amounts paid or incurred after
ar = advance refunding
apoaa = amounts paid or accrued after
apoii = amounts paid or incurred in
bia = bonds issued after
cmi = contributions made in
DOE = date of enactment
dda = decedents dying after
dpa = dividends paid after
dri = dividends received in

eca = exchanges completed after
gma = gifts made after
lai = losses accrued in
pma = payments made after
ppisa = property placed in service after
ppisi = property placed in service in
pyba = plan years beginning after
saea = sales and exchanges after
seaoda = sales, exchanges, and other dispositions after

spa = services performed after
sppoga = specified plants planted or grafted after
ta = transactions after
Ta = transfers after
topia = transfers of partnership interests after
tyba = taxable years beginning after

[Footnotes for JCX-52-17 appear on the following pages]

Footnotes for JCX-52-17:

[1] The parameters for the end of the 22.5% and 32.5% rate brackets, the beginning of the 38.5% rate bracket, and the standard deduction amount use 2018 as the base year. Other indexed parameters are adjusted for inflation from their 2017 values using the chained CPI-U as the inflation measure to determine 2018 values.

[2] Estimate includes the following outlay effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
10%, 12%, 22.5%, 25%, 32.5, 35%, and 38.5% tax brackets	---	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.3	1.3	4.4	10.6
Modify standard deduction	---	9.4	9.7	10.2	10.4	10.5	10.6	10.7	10.9	11.1	39.7	9[illegible].6
Repeal personal exemptions	-10.8	-15.9	-16.4	-16.6	-16.9	-17.2	-17.4	-17.7	-17.9	-18.1	-76.6	-164.9
Alternative inflation methods	---	-0.3	-0.6	-1.3	-1.6	-2.1	-2.5	-3.1	-3.6	-4.0	-3.9	-19.2
Modification of child tax credit	---	14.1	14.3	14.2	14.2	15.7	15.7	15.6	15.6	16.9	56.7	136.2
Change in information reporting thresholds	---	---	[22]	[22]	[22]	[22]	[22]	[22]	[22]	[22]	0.1	0.2
Require valid Social Security number of each child to claim refundable portion of child credit	---	-2.9	-2.8	-2.7	-2.6	-2.7	-2.6	-2.5	-2.6	-2.7	-11.1	-24.1
Repeal of itemized deductions for taxes not paid or accrued in a trade or business, interest on home equity debt, non-disaster casualty losses and certain miscellaneous expenses	---	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.5	-1.5	-3.7
Repeal of alternative minimum tax on corporations	10.8	3.8	-0.4	-0.3	---	---	---	---	---	---	13.9	13.9

[3] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect (SECA interaction)	-1.3	-1.8	-1.6	-1.3	-0.9	1.7	2.7	1.9	1.4	1.1	-6.8	2.1
On-budget effects	-0.2	-0.4	-0.3	-0.3	-0.2	0.3	0.6	0.4	0.3	0.2	-1.4	0.4
Off-budget effects	-1.0	-1.4	-1.2	-1.0	-0.7	1.4	2.2	1.5	1.1	0.9	-5.4	1.6

[4] Gain of less than $50 million.

[5] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	2.7	6.1
On-budget effects	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6	2.2	4.8
Off-budget effects	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.6	1.3

[6] Estimate includes policy that retains exclusion under section 217(g) (related to members of the Armed Forces).

[7] The expansion of the threshold allowing the use of the cash method, the creation of an exemption from the requirement to use inventories, and the expansion of the exception from the uniform capitalization rules are effective for taxable years beginning after December 31, 2017. The expansion of the exception from the requirement to use the percentage of completion method is effective for contracts entered into after December 31, 2017, in taxable years ending after such date. The threshold applicable to each provision is indexed for inflation for taxable years beginning after December 31, 2018.

[8] Estimate contains interaction with the section 179 expansion in II.C.1.

[9] Loss of less than $50 million.

[10] Estimate includes the following provisions: for nonresidential real property, reduce the applicable recovery period to 25 years from 39 years; for residential rental property, reduce the applicable recovery period to 25 years from 27.5 years; for qualified improvement property, reduce the applicable recovery period to 10 years from 15 years.

[11] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	1.6	2.0	2.1	2.1	2.2	2.3	2.4	2.5	2.6	2.6	10.0	22.4
On-budget effects	1.3	1.6	1.7	1.8	1.8	1.9	2.0	2.1	2.1	2.2	8.2	18.5
Off-budget effects	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.8	3.9

[Footnotes for Table JCX-52-17 continue on the following page]

Footnotes for JCX-52-17 continued:

[12] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	1.3	1.5	1.7	1.7	1.8	1.8	1.8	1.9	1.9	2.0	7.9	17.4
On-budget effects	1.0	1.2	1.3	1.3	1.4	1.4	1.5	1.5	1.5	1.6	6.4	13.9
Off-budget effects	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	1.6	3.5

[13] Generally effective for amounts paid or incurred after December 31, 2017, with a transition rule providing that for buildings owned or leased at all times after December 31, 2017, the 24-month period for making qualified rehabilitation expenditures begins no later than 180 days after the date of enactment, and the repeal is effective for such expenditures paid or incurred after the end of the taxable year in which such 24-month period ends.

[14] Generally effective for amounts attributable to services performed after December 31, 2017. Amounts attributable to services performed before January 1, 2018, are included in income at the later of vesting (as defined under the proposal) or 2026.

[15] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	-0.1	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-1.3	-3.4
On-budget effects	[9]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.7
Off-budget effects	[9]	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-1.0	-2.7

[16] Generally effective for services performed after December 31, 2017, though section 7706(d)(1)(C) requirements are not to be enforced for compensation paid prior to 180 days after the date of enactment.

[17] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	---	0.2	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	1.3	3.6
On-budget effects	---	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.7	1.9
Off-budget effects	---	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.6	1.7

[18] Effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

[19] Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and all subsequent taxable years of foreign corporations and for the taxable years of a United States shareholder with or within which such taxable years end.

[20] Effective for distributions made in taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

[21] Effective for taxable years of foreign corporations beginning after December 31, 2019, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

[22] Increase in outlays of less than $50 million.

RE: SFC Chairman's Mark and Revenue Table

From:	"Lawless, Julia (Finance)" <julia_lawless@finance.senate.gov>
To:	"Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>, "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, "Knight, Shahira E. EOP/WHO" <Shahira Knight, EOP [redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Cc:	"Khosla, Jay (Finance)" <jay_khosla@finance.senate.gov>, "Hickman, Bryan (Finance)" <bryan_hickman@finance.senate.gov>, "Niederee, Katie (Finance)" <katie_niederee@finance.senate.gov>
Date:	Thu, 09 Nov 2017 20:46:46 -0500
Attachments:	11.9.17 Charge and Response.pdf (130.78 kB); 11.9.17 Real World Examples.pdf (128 kB); 11.9.17 Policy Highlights.pdf (130.35 kB); 11.9.17 Committee History.pdf (467.15 kB)

Attached, please find additional documents:

Charge & Response
Real World Examples
Policy Highlights
SFC Committee History in Tax Space

Let us know if you need anything else.

Julia Lawless
Communications Director
U.S. Senate Finance Committee
Chairman Orrin Hatch (R-Utah)

From: Dunn, Brendan (McConnell)
Sent: Thursday, November 9, 2017 8:27 PM
To: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Knight, Shahira E. EOP/WHO <Shahira Knight, EOP [redacted]>; Justin.Muzinich@treasury.gov
Cc: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Hickman, Bryan (Finance) <Bryan_Hickman@finance.senate.gov>; Niederee, Katie (Finance) <Katie_Niederee@finance.senate.gov>; Lawless, Julia (Finance) <Julia_Lawless@finance.senate.gov>
Subject: RE: SFC Chairman's Mark and Revenue Table

Sounds good

Brendan M. Dunn
Policy Advisor and Counsel
Office of the Senate Majority Leader

From: Prater, Mark (Finance)
Sent: Thursday, November 09, 2017 8:27 PM
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>; Knight, Shahira E. EOP/WHO <Shahira Knight, EOP [redacted]>; Justin.Muzinich@treasury.gov
Cc: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Hickman, Bryan (Finance) <Bryan_Hickman@finance.senate.gov>; Niederee, Katie (Finance) <Katie_Niederee@finance.senate.gov>; Lawless, Julia (Finance) <Julia_Lawless@finance.senate.gov>
Subject: RE: SFC Chairman's Mark and Revenue Table

Have to have the notice approved before it goes out. I'll give you the high sign after that occurs. Thanks.

From: Dunn, Brendan (McConnell)
Sent: Thursday, November 09, 2017 8:25 PM
To: Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Knight, Shahira E. EOP/WHO <[redacted]>; Justin.Muzinich@treasury.gov
Cc: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Hickman, Bryan (Finance) <Bryan_Hickman@finance.senate.gov>; Niederee, Katie (Finance) <Katie_Niederee@finance.senate.gov>; Lawless, Julia (Finance) <Julia_Lawless@finance.senate.gov>
Subject: RE: SFC Chairman's Mark and Revenue Table

So OK to flip at 8:50?

Lawless, can you flip the other 2 documents?

Maybe give people a taste on the Charge / Response and 2 pager (that everyone has)?

Brendan M. Dunn
Policy Advisor and Counsel
Office of the Senate Majority Leader

From: Prater, Mark (Finance)
Sent: Thursday, November 09, 2017 8:20 PM
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>; Knight, Shahira E. EOP/WHO <[redacted]>; Justin.Muzinich@treasury.gov
Cc: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Hickman, Bryan (Finance) <Bryan_Hickman@finance.senate.gov>; Niederee, Katie (Finance) <Katie_Niederee@finance.senate.gov>; Lawless, Julia (Finance) <Julia_Lawless@finance.senate.gov>
Subject: SFC Chairman's Mark and Revenue Table

FYI..

Please hold tight for 30 minutes. We want to send to SFC member offices first per committee protocol. Thanks.

TAX REFORM

United States Senate
COMMITTEE ON FINANCE

Charge and Response

The Senate Finance Committee's tax proposal is a critical step toward achieving pro-American, fiscally responsible tax reform. This proposal is the culmination of years of work at the Finance Committee, including more than 70 hearings, multiple working groups, option papers and reports. This comprehensive plan was also crafted based on a unified tax reform framework, put forth in September with the administration and other congressional leaders.

The chairman's mark will continue through regular order, including a robust vetting and markup process in the Finance Committee – all crucially important steps as Republicans advance their shared goal of delivering strong, pro-growth tax reform to the American people.

The following charge and response is designed to highlight current attacks and suggested responses to help set the record straight and put an end to the false narratives on tax reform.

CHARGES: More Tax Cuts for the Rich & Corporate America

- Tax Cuts for the Wealthy
- Tax Breaks for Corporate America
- Small Business Loophole to Benefit the Rich
- Death Tax Changes Benefit the Wealthy

CHARGE: The Finance Committee bill is just a tax cut for the wealthy.

RESPONSE: False. The Finance Committee mark cuts tax rates across the board. The mark also repeals a number of tax credits and benefits, including many that predominantly benefit wealthy taxpayers, so the lower rate will apply to a larger income base.

The bill also:
- Nearly doubles the standard deduction from $6,350 to $12,000 for individuals, from $12,700 to $24,000 for married couples, from $9,300 to $18,000 for single parents.
- Expands the child tax credit from $1,000 to $1,650 and allows many more parents to claim the credit by substantially lifting existing caps

Combined, these reforms mean lower taxes and bigger paychecks for tens of millions of middle-class American families.

In addition, the mark does not shift tax burden from higher-income earners to those in lower brackets, maintaining the progressivity of the current tax code.

BOTTOM LINE: The Finance Committee's primary focus is to provide much-needed tax relief to middle- and lower-income families and individuals, NOT to cut taxes for the wealthiest Americans.

CHARGE: The Finance Committee mark is just another tax break for major corporations.

RESPONSE: Over the last two decades, the vast majority of America's foreign competitors have aggressively reduced their corporate tax rates while the United States has steadily maintained a 35 percent rate, the highest corporate tax rate in the industrialized world.

The Finance Committee mark lowers the corporate tax rate to 20 percent, which is roughly on par with America's trading partners. And, the mark pays for much of the rate reduction with a combination of increased economic growth and corporate tax offsets. The mark will also move the United States from a worldwide tax system to a more territorial system, allowing American companies to bring foreign earnings back to the United States to invest in our economy without facing unfair and uncompetitive tax consequences.

BOTTOM LINE: The committee's corporate tax reforms will increase wages for middle-class workers, create more U.S. jobs, and prevent more jobs and capital from being shipped overseas. In fact, the Council for Economic Advisors estimated these reforms could raise household incomes by $4,000 per year or more.

CHARGE: The bill creates a massive loophole to allow wealthy people to pay taxes as business entities.

RESPONSE: False. The Finance Committee mark will allow small business owners to deduct a portion of their "pass-through" business income on their individual tax returns. The deduction will not apply to normal compensation paid to business owners and will be subject to strict requirements to prevent high-income earners from re-characterizing personal income as business income in order to use the deduction.

BOTTOM LINE: Small businesses employ nearly half of all U.S. workers and create the majority of new American jobs. The Finance Committee proposal provides much-needed tax relief for small businesses, allowing them to expand, invest, hire more workers and increase wages, while also preventing people from gaming the system.

CHARGE: The mark repeats the mistakes of Kansas' "pass-through" tax system

RESPONSE: False. Comparing the Kansas tax plan to the Finance Committee proposal is an apples and oranges comparison. While it appeared that some people in Kansas were able to game the system in order to take advantage of a zero percent pass-through rate, the Finance Committee proposal does not exempt pass-through income from taxation. Instead, it allows small business owners with pass-through income to deduct a portion of that income on their individual returns. The mark includes safeguards to prevent people from re-characterizing personal income as business income in order to use the deduction.

BOTTOM LINE: The Finance Committee proposal includes a simple and safe means of providing much-needed tax relief for small businesses – the engines of American job creation, while also preventing people from gaming the system.

CHARGE: Changes to the death tax will simply benefit the rich.

RESPONSE: The death tax, an unfair double tax, negatively impacts family-owned businesses and farms throughout the country, burdening those who have worked their entire lives to build successful companies and create jobs. These families should not have to fear double taxation from Washington when they pass down their life's work to the next generation.

While many Democrats – including Sens. Ron Wyden, Bill Nelson, Joe Manchin, Dianne Feinstein and Patty Murray – have acknowledged this reality and voted to repeal the death tax, the Finance Committee mark would simply increase the death tax exemption to reduce uncertainty for family-owned farms and businesses by making it less likely that Washington will impose an unnecessary and unfair layer of tax on Americans who want to pass on their life's work to the next generation.

BOTTOM LINE: The death tax punishes Americans for building up farms and businesses and passing them on to future generations. The Finance Committee mark mitigates much of the death tax's adverse impact.

CHARGES: More Tax Cuts for the Rich & Corporate America

- Bracket Changes Raise Taxes on Low-Income Americans
- Eliminating Itemized Deductions Hurts Middle Class
- Changes to SALT Harmful to Middle Class
- Changes affecting Mortgage Interest Deductions Hurt Middle-Class Home Values
- Can't Guarantee a Middle-Class Tax Cut

CHARGE: The Finance Committee plan raises taxes on the poor.

RESPONSE: The committee's chief focus is lowering taxes for the poor and middle class. By nearly doubling the standard deduction, the mark reduces the tax burden for tens of millions of lower- and middle-income families and greatly expands the zero percent tax bracket. In addition, the mark lowers the current 15 percent bracket to 12 percent and maintains the 10 percent bracket to cover those who rely on itemized deductions instead of the standard deduction to qualify for the bottom rate.

The committee proposal also significantly increases the Child Tax Credit from $1,000 per child to $1,650 per child, and maintains other provisions that are important to low- and middle-income families.

BOTTOM LINE: Low-income Americans will be some of the biggest beneficiaries of the Finance Committee tax reform mark.

CHARGE: This proposal hurts the middle class by eliminating itemized deductions.

RESPONSE: False. The Finance Committee mark provides across-the-board tax relief, with a particular focus on hardworking, middle-class Americans.

The elimination of most itemized deductions will have NO impact on the nearly three-quarters of American families who currently itemize. For the less than 30 percent of taxpayers who itemize today, the benefit of lower tax rates, a larger standard deduction and enhanced child tax credits will largely outweigh the loss of itemized deductions.

Importantly, the mark retains the deductions for home mortgage interest and charitable contributions, two of the most popular and important deductions for the middle class.

BOTTOM LINE: Every major provision within the tax code has an important constituency and consequence. The Finance Committee mark strikes an appropriate balance between important deductions that should be maintained and those that should be repealed in order to reduce the overall tax burden on middle class Americans.

CHARGE: Eliminating the state and local tax (SALT) deduction, one of the biggest of itemized deductions, will hurt the middle class.

RESPONSE: The Finance Committee's chief focus is on providing relief for low- and middle income Americans. The SALT deduction disproportionately benefits those who make more than $500,000 per year as well as those who live in high-tax cities and states. In fact, one-third of the deduction's benefits go to the top one percent of earners, while practically no benefit goes to those in the bottom half.

Nearly three-quarters of American families already claim the standard deduction, meaning that repealing the SALT deduction will have absolutely no impact on them. The vast majority of middle-class families who currently itemize their deductions should fare better with other changes, including a lower tax rate, larger standard deduction and enhanced Child Tax Credit than with the SALT deduction.

BOTTOM LINE: Repealing the SALT deduction, which has a very hefty price tag in terms of revenue, will help reduce the tax burden on the middle class while mostly impacting high-income taxpayers in states and cities with disproportionately high tax rates.

CHARGE: Changes to the mortgage interest deduction will hurt the value of middle-class homes and the broader real estate market.

RESPONSE: The home mortgage interest deduction is explicitly retained in the Finance Committee mark. While fewer people will claim the mortgage interest deduction under the Finance Committee proposal due to the expanded standard deduction, most middle-class families will see a significant decrease in their tax liability, in most cases exceeding the itemized deductions they claim today, ultimately lowering their tax bill.

Historically, growth in the housing market correlates very closely with growth in the economy and not with tax rates. And, larger after-tax paychecks for middle-class workers and a stronger economy will strengthen, not weaken, housing markets.

BOTTOM LINE: The mark will maintain the core of the home mortgage without harming home values or the housing market.

CHARGE: The Finance Committee tax plan does not cut taxes for the middle class.

RESPONSE: This is simply false. Under this proposal, a typical family of four earning the median family income (around $73,000) will see its taxes cut by nearly $1,500. The bill will also reduce the tax burden on small businesses and put American companies on a level playing field with their foreign competitors in order to grow the economy and create more jobs here at home.

CHARGES: A Fiscal Fiasco, Lacks Permanence & Is Partisan

- Tax Reform Will Add Trillions to the Debt
- Tax Cuts Pay for Themselves
- Lacks Permanence & Results in Uncertainty
- Partisan Exercise
- Written in the Dark of Night

CHARGE: This proposal is fiscally irresponsible, adding trillions to the debt.

RESPONSE: The proposal will make concrete reforms to the broken U.S. tax code and put the American economy back on a growth track. The plan is mostly paid for with a combination of economic growth and reforms that broaden the tax base by eliminating special interest tax breaks.

This tax plan is an investment in the middle class – one that will produce more jobs, higher wages and a stronger and more competitive American economy.

CHARGE: Since tax reform is being done through reconciliation, the bill will lack permanence and sunset in 10 years.

RESPONSE: When we crafted this mark, one of our goals was to provide Americans with as much certainty and tax permanence as possible. Given that this is a once-in-a-generation opportunity to make much-needed changes to the tax code, getting pro-growth and pro-middle-class tax reform policies in the books with as much permanence as possible is the best way forward.

CHARGE: Republicans are excluding Democrats by doing tax reform through reconciliation.

RESPONSE: Reconciliation is simply a procedural tool that removes the 60-vote threshold for certain types of legislation in the Senate. If you look back to major tax bills in recent decades, you'll see that most of them were done through reconciliation and that they ultimately had bipartisan support. Republicans have invited and welcomed the support of Democrats.

Many Democrats are on the record in support of many of the very reforms contained in the Finance Committee mark, including middle class tax relief, reduced corporate tax rates, and movement to a territorial tax system. This suggests their complaints about the mark are more about politics than policy.

BOTTOM LINE: Nothing about the reconciliation process precludes Democrats from engaging in tax reform. The decision to not participate in this endeavor is theirs alone. The claim that reconciliation somehow prevents them from participating is a transparent excuse for putting politics ahead of reform.

CHARGE: Senators don't even know what's in the proposal.

RESPONSE: Members of the Senate Finance Committee, along with members off the committee, have been meeting for months to address goals and concerns. The mark was drafted with the direct input of Finance Committee members.

There will be a full committee markup and a fair and robust floor debate. Every member of the Senate will have ample opportunity to read the bill, opine about its contents, and offer changes.

BOTTOM LINE: There are no legitimate complaints to be made about process. This entire endeavor has been transparent and years in the making.

For more information, visit the Senate Finance Committee's website at finance.senate.gov/taxreform.

TAX CUTS & JOBS ACT

United States Senate
COMMITTEE ON FINANCE

Real World Impact

How the Senate proposal will help Americans

Family of four earning $73,000

- A family of four with income of around **$73,000** (median family income) will see a tax cut of nearly **$1,500.**
- Their tax bill will fall from what they pay today, around $3,683, to paying $2,199 next year—**a reduction of $1,484.**
- This represents a reduction in their tax bill of more than **40 percent.**

Single parent with income of $41,000

- A single parent with an income of **$41,000** will see a tax cut of more than **$1,000**.
- Their tax bill will fall from what they are paying today, around $1,865, to paying $838 next year—**a reduction of $1,027.**
- This represents a reduction in their tax bill of **55 percent**, meaning that their tax bill next year will be less than half of what it is today.

Married small business owners with income of $100,000

- A couple earning **$100,000**, with $60,000 from wages, $25,000 in compensation from their non-corporate business, and $15,000 of business income, will see a tax cut of more than $2,850.
- Their tax bill will fall from what they pay today, around $11,280, to paying around $8,425 next year—**a reduction of $2,855.**
- This represents a reduction in their tax bill of more than **25 percent.**

TAX CUTS & JOBS ACT

United States Senate
COMMITTEE ON FINANCE

Policy Highlights

The Tax Cuts and Jobs Act provides fiscally responsible middle-class tax relief by cutting tax rates across the board, reducing the tax burden on American job creators and modernizing our tax system. Under this proposal, a typical family of four earning the median family income (around $73,000) will see its taxes cut by nearly $1,500. The bill will also reduce the tax burden on small businesses and put American companies on a level playing field with their foreign competitors in order to grow the economy and create more jobs here at home.

Combined, all of this will mean bigger paychecks for middle-class workers and families, more American jobs and a stronger U.S. economy.

RELIEF FOR AMERICAN WORKERS AND FAMILIES

The Tax Cuts and Jobs Act:

- Lowers individual tax rates for low- and middle-income Americans by effectively expanding the zero tax bracket and maintaining a 10 percent bracket, allowing hardworking taxpayers to keep more of their hard-earned money, make ends meet, and save for retirement. The bill includes a reformed rate structure that targets tax relief to the middle class while maintaining the existing tax distribution, and a 38.5 percent bracket for high-income earners.

- Nearly doubles the standard deduction to reduce or eliminate the federal income tax burden for tens of millions of American families. The standard deduction will increase from $6,350 to $12,000 for individuals and from $12,700 to $24,000 for married couples. For single parents, the standard deduction will increase from $9,300 to $18,000.

- Recognizes the unique challenges faced by parents with young children by:
  - Expanding the child tax credit from $1,000 to $1,650 and allowing many more parents to claim the credit by substantially lifting existing caps;
  - Preserving the child and dependent care tax credit to help working parents care for their children and older dependents – such as an aging grandparent – who need support;
  - Preserving the adoption tax credit to help families with the high costs of adopting children; and
  - Allowing parents to more effectively save for the education costs of unborn children.

- Preserves the deduction for charitable contributions, continuing a long recognition of the importance of private philanthropy for the churches and community organizations that daily provide aid and assistance to those in need.

- Protects the home mortgage interest deduction for existing mortgages and maintains the deduction for newly purchased homes up to $1 million. This incentive for homeownership provides tax relief to current and aspiring homeowners.

- Continues popular retirement savings programs such as 401(k)s and Individual Retirement Accounts, to help Americans build their retirement nest eggs and prepare for the future.

RELIEF FOR AMERICAN WORKERS AND FAMILIES (continued)

- Preserves the earned income tax credit to provide tax relief to low-income Americans working to build better lives for themselves.

- Preserves additional important elements of the existing individual tax system, including:
  - Deduction for medical expenses
  - Enhanced standard deduction for the blind and elderly
  - Education relief for graduate students

- Repeals the alternative minimum tax (AMT) to simplify the tax code and eliminate uncertainty for millions of Americans who are required to calculate their taxes twice each year.

- Provides relief from the death tax by doubling the current exemption. This will reduce uncertainty and costs for family-owned farms and businesses by making it less likely that Washington will impose an unnecessary layer of taxation on Americans who want to pass on their life's work to the next generation.

RELIEF FOR JOB CREATORS OF ALL SIZES

- Permanently lowers the corporate tax rate to 20 percent so American companies no longer have to face the highest tax rate in the industrialized world, which will allow them to better compete in the global marketplace, create more jobs and increase wages.

- Substantially lowers the tax burden on Main Street job creators through:
  - A simple and easy-to-administer deduction for pass-through businesses of all sizes, allowing more small businesses to grow, invest, hire new workers and increase wages while also preventing abuse of the reformed system;
  - Enhanced Section 179 expensing to promote business investment and growth; and
  - Enhanced cash accounting, allowing more businesses to use the simple cash-basis accounting method.

- Full and immediate expensing of new equipment, which encourages growth and increases investment, productivity and wages.

- Protects the ability of small businesses to deduct interest on loans that allows Main Street employers to expand, invest, and hire new workers.

- Preserves important elements of the existing business tax system, including:
  - Low-income housing credit to continue encouraging businesses to invest in affordable housing and provide individuals and families with expanded opportunities.
  - Research and development tax credit, which enhances investments in American products, technology and innovations.

- Permanently modernizes our outdated international tax system by eliminating the antiquated "worldwide" system, in order to eliminate double taxation, enhance the competitiveness of American companies, and bring business and investment back to the United States.

- Eliminates the "lock-out effect" by making it simpler and less onerous for American multinationals to bring foreign earnings back to America for investment and growth here at home.

- Makes the United States a better place to do business by eliminating incentives for companies to shift jobs, profits and intellectual property overseas, and by creating incentives for companies to both locate in America and bring economic activity back to America.

TAX CUTS & JOBS ACT

United States Senate
COMMITTEE ON FINANCE

Senate Finance Committee Takes on Tax Reform

Years of Analysis, Papers, Hearings and Legislating Lay the Groundwork for a Once-In-a Generation Tax Overhaul

The Senate Finance Committee, which has the largest committee jurisdiction in either chamber of Congress, oversees more than 50 percent of the federal budget and has jurisdiction over tax, trade and healthcare policy. Since U.S. Senator Orrin Hatch (R-Utah) became the top Republican on the committee, he's fought to enact a strong, pro-growth economic agenda to strengthen the American economy. At the top of that list is remaking the nation's tax code to better serve American job creators and hardworking, middle-class families across the country.

Here's a look at the committee's work by the numbers:

21 pages In 2011, then Ranking Member Hatch led Senate Finance Committee Republicans to submit 21 pages of recommendations to the Joint Select Committee on Deficit Reduction to help lay the groundwork for comprehensive tax reform.

10 papers Hatch and then-Chairman Max Baucus (D-Mont.) released 10 option papers as part of the "the blank slate" approach that was launched in 2013 to scrub the tax code and produce concrete policy solutions to bring the code into the 21st century.

7 principles In December 2014, Hatch released an extensive report titled, "Comprehensive Tax Reform for 2015 and Beyond." The report is not a tax reform plan, but a discussion of ideas and principles that outlines in detail seven key principles comprehensive tax reform should embrace, including economic growth, fairness, simplicity, and savings and investment, among others.

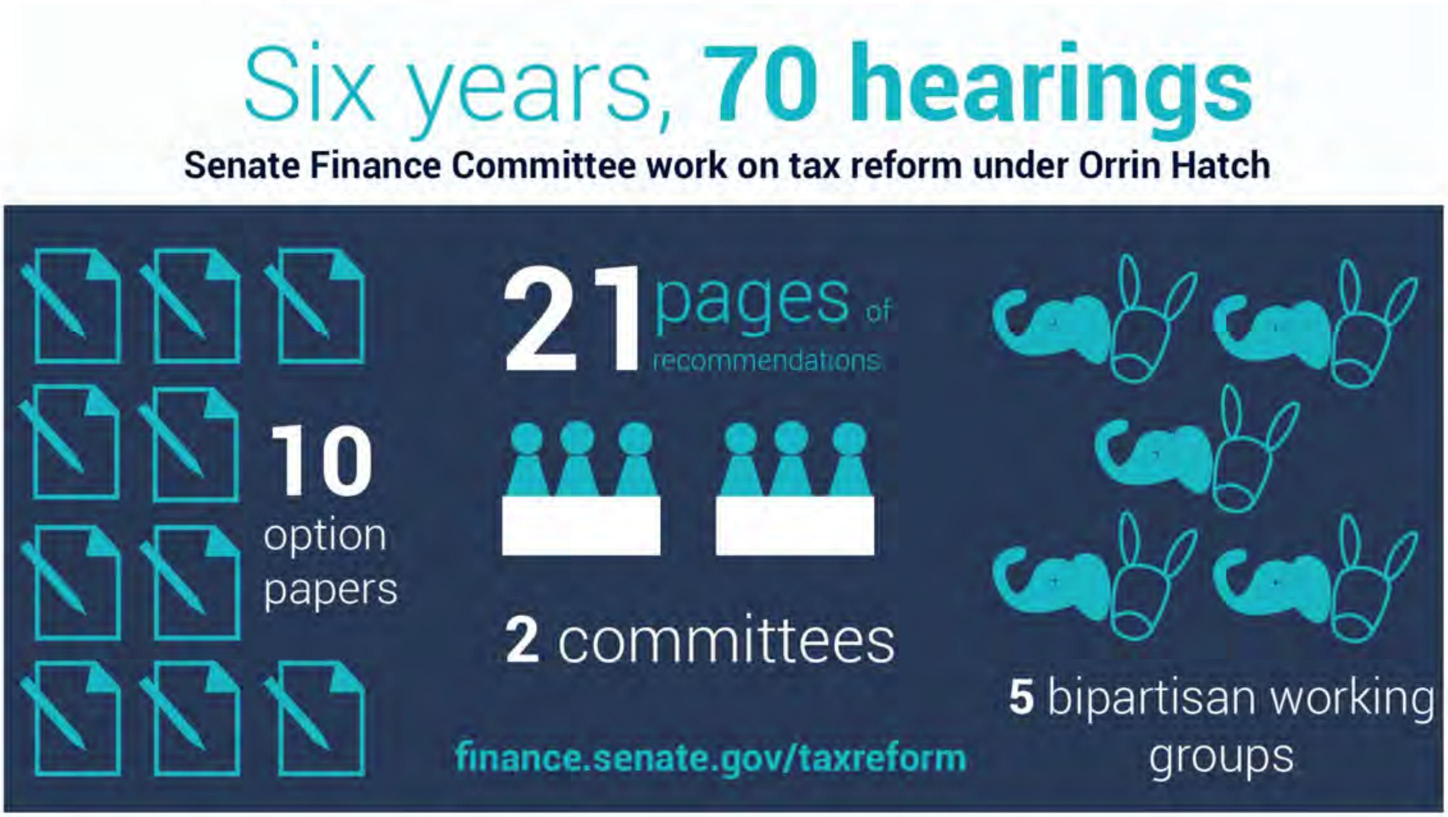
5 working groups During the 114th Congress, as chairman, Hatch launched five bipartisan Finance Committee tax working groups to help jumpstart congressional tax reform efforts. The groups produced bipartisan papers, which served as the foundation for additional hearings and helped to set the table for a real overhaul of the nation's tax code.

2 committees Under Chairman Hatch's leadership, the Senate Finance Committee marked up tax extenders legislation in July 2015. This action served as the foundation for the PATH Act, December 2015 legislation signed into law, which included a number of bipartisan legislative policies that were advanced by the two tax writing committees through open process and debate.

6 years, 70 hearings Over the last six years, the Senate Finance Committee has held 70 hearings on how the tax code can be improved and streamlined to work better for all Americans.

6 principals A recent joint statement by the six tax principals in the Senate, House and administration highlighted that there is unity among the legislative and executive branches and that the tax-writing committees would take the lead in drafting legislation.

The time to reform the broken tax code is now. A pro-growth tax plan will move the U.S. economy forward, helping to produce jobs and bigger paychecks for the American people, and allowing them to keep more of their hard-earned incomes.



For more information, visit the Senate Finance Committee's website at finance.senate.gov/taxreform.

###

Re: Congratulations

From: "Angus, Barbara" <barbara.angus@mail.house.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Fri, 10 Nov 2017 10:46:16 -0500

Thank you so much, Dan. It has been a privilege to be part of this effort. Lots more to come but it is exciting to have gotten through this first step!

Barbara M. Angus
Chief Tax Counsel
Committee on Ways and Means
202.225.5522

From: "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov>
Date: Friday, November 10, 2017 at 10:43 AM
To: "Angus, Barbara" <Barbara.Angus@mail.house.gov>
Subject: Congratulations

Barbara, I just wanted to congratulate you on getting the tax reform measure out of committee. It was a huge project, and vitally important for our efforts to get a tax bill to the President's desk. I haven't been particularly involved lately, but I'm still paying attention, and deeply appreciative of the personal effort I am sure you had to devote to the task.

Thank you.

Dan

Re: Congratulations

From: "Callas, George" <george.callas@mail.house.gov>
To: "Kowalski, Daniel" <daniel.kowalski@treasury.gov>
Date: Fri, 10 Nov 2017 11:19:10 -0500

Thanks, Dan!

From: "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov>
Date: Friday, November 10, 2017 at 10:46 AM
To: "Callas, George" <George.Callas@mail.house.gov>
Subject: Congratulations

George, I just wanted to congratulate you on getting the tax reform bill out of committee. Good luck on the floor next week.

Dan

Private Activity Bonds + Advanced Refundings

From: "Hulse, Bill" <bill.hulse@mail.house.gov>
To: "Bailey, Bradley" <bradley.bailey@treasury.gov>
Date: Fri, 10 Nov 2017 14:34:05 -0500

Brad – I wanted to quickly follow-up on the meeting we had with Treasury a month or two ago. As you no doubt saw, the House bill would eliminate private activity bonds and advanced refunding bonds. We were surprised by this. It also seems inconsistent with President Trump's call for infrastructure investment in the United States.

We were very pleased to see the Senate bill maintains PAB, but we would still like to see them address advanced refundings.

We are planning to keep talking to our House colleagues about this, but please let us know if there are any opportunity to work with Treasury / the Administration to address our concerns.

You might also be interested in the below Op-Ed that ran in the *Washington Examiner* this morning.
http://www.washingtonexaminer.com/protect-infrastructure-finance-in-tax-reform/article/2640182

Thanks,
Bill

Protect infrastructure finance in tax reform

by Rep. Randy Hultgren (R-IL) and Rep. Dutch Ruppersberger (D-MD)

Americans on both sides of the aisle agree: Our current tax code is complex, costly and time consuming. It hurts the ability of American businesses to grow and create new middle-class jobs, and for individuals to cover basic household costs. We believe it's time for real reforms that simplify the tax code, lower taxes on all Americans and their families and stimulate job growth.

We are encouraged by a number of the reforms proposed in the Tax Cuts and Jobs Act working its way through the House.

However, as Co-Chairs of the Municipal Finance Caucus, we are concerned by the serious threat posed to the tax-exempt status of private activity bonds. These tools are used regularly by states and local governments to fund important public goods such as healthcare facilities, affordable housing, schools and universities, airports, water and sewer facilities, commuting centers, and other important infrastructure.

This year, 162 members of Congress joined together in demonstrating the importance of municipal finance, including PABs, to fund the vast majority of infrastructure projects in their communities. In fact, President Trump has called for increasing infrastructure investment in the United States, and has underscored the idea of public and private institutions partnering to improve infrastructure. There are a number of proposals before Congress to *expand* upon the success of PABs.

The current tax-exempt status of PABs made it possible for Presence Health, the largest

Catholic health system in Illinois, to refinance its debt, ensuring its continued services would be made available to hundreds of thousands of the neediest individuals and families across the state. Constituents in Illinois' 14th District depend on Presence to access their Medicaid benefits. The University of Chicago has used these bonds for every building at their medical center, including specialized care for children and cancer patients.

In Maryland, construction crews broke ground earlier this year on a long-awaited light rail line. Conceived more than three decades ago, the line was made possible only with a private activity bond — leveraging federal, state, and private sector dollars. Not only is it expected to relieve traffic across three counties — in the state with the nation's second-longest commutes — but the new line will create 52,000 new jobs.

We strongly encourage our colleagues in Congress to seriously reconsider what losing the tax-exempt status of PABs will mean for their districts before agreeing to advance this misguided and misunderstood change to the tax code that will stunt job growth for years to come.

Randy Hultgren, a Republican, represents Illinois' 14th Congressional District and is a member of the House Financial Services Committee. Dutch Ruppersberger, a Democrat, represents Maryland's 2nd Congressional District and is a member of the House Appropriations Committee.

Bill Hulse | Legislative Assistant
U.S. Representative Randy Hultgren (IL-14)
2455 Rayburn | Washington, DC 20515
Office: (202) 225-2976
Website | Facebook | Twitter

Re: JCT score of HR1

From: "Maloney, Drew" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=0aa00d7c98de43f9aec8f68a919f6fe3-maloney, drew">
To: "Knight, Shahira E. EOP/WHO" <Shahira Knight, EOP [redacted]>, "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>
Cc: "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Fri, 10 Nov 2017 16:28:34 -0500

We will reach out again. Not sure we can score, but can offer some help.

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: (b) (6) [redacted]
drew.maloney@treasury.gov

From: Knight, Shahira E. EOP/WHO <Shahira.E.Knight@who.eop.gov>
Date: November 10, 2017 at 1:57:05 PM EST
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Muzinich, Justin <Justin.Muzinich@treasury.gov>, Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: Re: JCT score of HR1

Copying Drew as I believe he told Sen. Johnson he would connect him with Treasury folks. Thanks.

On Nov 10, 2017, at 1:34 PM, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov> wrote:

b(5) [redacted]

From: Sean Riley <Sean_Riley@ronjohnson.senate.gov>
Date: Friday, November 10, 2017 at 1:31 PM
To: Brendan Dunn <Brendan_Dunn@mcconnell.senate.gov>
Subject: Re: JCT score of HR1

Brendan—Senator Johnson needs the following info to move forward:

(b) (5) [redacted]

Can you help?

From: Sean Riley <Sean_Riley@ronjohnson.senate.gov>

Date: Tuesday, November 7, 2017 at 11:20 PM
To: "Dunn, Brendan (McConnell)" <Brendan_Dunn@mcconnell.senate.gov>
Subject: Re: JCT score of HR1

Thank you

Sent from my iPhone

On Nov 7, 2017, at 10:48 PM, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov> wrote:

> From SFC staff.
> b(5) [redacted]
>
> ___________________________________
>
> Using a common reform template (including reduced individual income tax rates at 12, 25, and 35 percent, an expanded standard deduction, repeal of certain itemized deductions, repeal of the estate and generation-skipping transfer taxes, repeal of the corporate and individual AMT, a 20 percent corporate tax rate, repeal of section 199 (domestic manufacturing deduction), 50 percent bonus deprecation for seven years, reduced interest expense deduction, and limiting the deduction for net operating losses to 90 percent of income), the Joint Committee on Taxation (JCT) estimates that a 25-percent maximum rate on the active business income of pass-through entities (similar to the provision in the House Ways & Means tax reform bill) generally costs in the **$400-$430 billion range over 10 years**.
>
> At the request of GOP Finance Committee members, JCT modified the reform template above to allow S corporations to elect to use a "reasonable compensation" standard to determine the portion of their income that is treated as labor income (with the remainder qualifying for the beneficial tax rate). In general, JCT would expect that many S corporations would make this election, as the reasonable compensation standard as interpreted by the courts does not measure market rates of pay, but rather generously permits reasonable compensation to understate the value the individual could achieve in the market. In addition, the Internal Revenue Service's ability to challenge reasonable compensation assertions on a diminished budget should encourage aggressive application of the lax standard. Further, partnerships, sole proprietorships, and farms would have incentives to convert to S corporation form to avoid treating income from the activity as labor income. Given that, JCT has estimated that, using the common reform template described above but allowing for S corporations to elect to use a "reasonable compensation" approach, would increase the cost of the 25 percent maximum rate on the active business income of pass-through entities to **over $850 billion over 10 years**.

Year Delay

From: "Plack, Brendon (Thune)" <brendon_plack@thune.senate.gov>
To: Amy Swonger <Amy Swonger, EOP [redacted]>, "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Sat, 11 Nov 2017 12:06:56 -0500
Attachments: Thune Results 11-9.xlsx (21.31 kB)

Hey guys, b(5) [redacted]
b(5) [redacted]
b(5) [redacted] Just an fyi for now.

Sent from my Verizon, Samsung Galaxy smartphone

RE: Year Delay

From: "Maloney, Drew" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=0aa00d7c98de43f9aec8f68a919f6fe3-maloney, drew">

To: "Plack, Brendon (Thune)" <brendon_plack@thune.senate.gov>, Amy Swonger <Amy Swonger, EOP [redacted]>

Date: Sat, 11 Nov 2017 12:33:11 -0500

Thanks Brendon

From: Plack, Brendon (Thune) [mailto:Brendon_Plack@thune.senate.gov]
Sent: Saturday, November 11, 2017 12:07 PM
To: Amy Swonger <Amy Swonger, EOP [redacted]; Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: Year Delay

Hey guys. b(5) [redacted] b(5) b(5) Just an fyi for now.

Sent from my Verizon, Samsung Galaxy smartphone

Estimated distributional analysis of the Chairman's mark

From: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>
To: "Knight, Shahira E. EOP/WHO" <Shahira Knight, EOP [redacted]>, "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Sat, 11 Nov 2017 17:46:33 -0500
Attachments: D-17-48.pdf (107.44 kB)

Hey guys,

Embargoed until 6:10 p.m.

b(5) [redacted]

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017 (1)

Calendar Year 2019

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000.........	-$405	-5.7%	$7.0	0.2%	$6.6	0.2%	9.1%	8.6%
$10,000 to $20,000........	-$1,509	(5)	-$2.4	-0.1%	-$3.9	-0.1%	-0.7%	-1.2%
$20,000 to $30,000........	-$2,308	-10.4%	$22.1	0.7%	$19.8	0.7%	3.9%	3.5%
$30,000 to $40,000........	-$3,791	-8.1%	$47.0	1.5%	$43.2	1.4%	7.9%	7.3%
$40,000 to $50,000........	-$5,245	-7.8%	$67.3	2.1%	$62.0	2.0%	10.9%	10.1%
$50,000 to $75,000........	-$18,845	-7.1%	$265.3	8.2%	$246.5	8.1%	14.8%	13.7%
$75,000 to $100,000......	-$16,702	-6.0%	$279.5	8.7%	$262.8	8.6%	17.0%	15.9%
$100,000 to $200,000.....	-$47,287	-5.0%	$939.8	29.1%	$892.5	29.3%	20.9%	19.9%
$200,000 to $500,000.....	-$37,755	-5.2%	$724.3	22.4%	$686.5	22.6%	26.4%	25.0%
$500,000 to $1,000,000..	-$19,138	-7.5%	$254.7	7.9%	$235.6	7.7%	30.9%	28.5%
$1,000,000 and over.......	-$33,217	-5.3%	$624.1	19.3%	$590.9	19.4%	32.5%	30.4%
Total, All Taxpayers......	**-$186,203**	**-5.8%**	**$3,228.7**	**100.0%**	**$3,042.5**	**100.0%**	**20.7%**	**19.4%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$2.412 billion to -$3.912 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017 (1)

Calendar Year 2021

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	**Proposal**
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000.........	-$251	-3.6%	$6.9	0.2%	$6.7	0.2%	8.2%	7.9%
$10,000 to $20,000........	-$1,082	(5)	-$4.9	-0.1%	-$6.0	-0.2%	-1.4%	-1.7%
$20,000 to $30,000........	-$2,098	-9.3%	$22.5	0.6%	$20.5	0.6%	3.7%	3.3%
$30,000 to $40,000........	-$3,521	-7.4%	$47.7	1.4%	$44.2	1.3%	7.6%	7.0%
$40,000 to $50,000........	-$5,224	-7.1%	$73.7	2.1%	$68.4	2.1%	10.9%	10.1%
$50,000 to $75,000........	-$18,317	-6.5%	$283.4	8.1%	$265.1	8.0%	14.7%	13.7%
$75,000 to $100,000......	-$15,875	-5.3%	$300.3	8.6%	$284.5	8.5%	16.8%	15.9%
$100,000 to $200,000.....	-$43,558	-4.3%	$1,017.6	29.1%	$974.0	29.2%	20.9%	20.0%
$200,000 to $500,000.....	-$33,423	-4.2%	$799.8	22.9%	$766.4	23.0%	26.5%	25.3%
$500,000 to $1,000,000..	-$16,974	-6.1%	$279.4	8.0%	$262.5	7.9%	31.0%	29.0%
$1,000,000 and over.......	-$24,993	-3.7%	$671.8	19.2%	$646.8	19.4%	32.4%	31.0%
Total, All Taxpayers......	**-$165,316**	**-4.7%**	**$3,498.3**	**100.0%**	**$3,333.0**	**100.0%**	**20.7%**	**19.6%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$4.888 billion to -$5.970 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017 (1)

Calendar Year 2023

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000.........	-$35	-0.5%	$6.4	0.2%	$6.4	0.2%	7.0%	7.0%
$10,000 to $20,000........	-$538	(5)	-$5.0	-0.1%	-$5.6	-0.2%	-1.3%	-1.5%
$20,000 to $30,000........	-$1,733	-7.0%	$24.7	0.7%	$22.9	0.6%	3.7%	3.5%
$30,000 to $40,000........	-$2,865	-5.6%	$51.0	1.4%	$48.2	1.3%	7.6%	7.2%
$40,000 to $50,000........	-$4,480	-5.5%	$80.9	2.1%	$76.4	2.1%	10.8%	10.2%
$50,000 to $75,000........	-$15,359	-5.0%	$305.2	8.1%	$289.8	7.9%	14.6%	13.8%
$75,000 to $100,000......	-$12,226	-3.8%	$325.9	8.6%	$313.7	8.5%	16.6%	16.0%
$100,000 to $200,000.....	-$28,909	-2.6%	$1,103.4	29.3%	$1,074.5	29.2%	20.8%	20.2%
$200,000 to $500,000.....	-$17,787	-2.1%	$863.6	22.9%	$845.8	23.0%	26.5%	25.9%
$500,000 to $1,000,000..	-$9,103	-3.1%	$297.6	7.9%	$288.5	7.8%	30.8%	29.8%
$1,000,000 and over.......	-$1,873	-0.3%	$717.5	19.0%	$715.7	19.5%	32.2%	32.0%
Total, All Taxpayers......	**-$94,873**	**-2.5%**	**$3,771.1**	**100.0%**	**$3,676.2**	**100.0%**	**20.5%**	**20.0%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$5.044 billion to -$5.582 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017 (1)

Calendar Year 2025

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000.........	-$60	-1.0%	$5.9	0.1%	$5.8	0.1%	5.8%	5.8%
$10,000 to $20,000........	-$685	(5)	-$4.7	-0.1%	-$5.3	-0.1%	-1.1%	-1.3%
$20,000 to $30,000........	-$1,857	-6.8%	$27.2	0.7%	$25.3	0.6%	3.8%	3.6%
$30,000 to $40,000........	-$2,986	-5.6%	$53.7	1.3%	$50.7	1.3%	7.5%	7.1%
$40,000 to $50,000........	-$4,830	-5.5%	$88.0	2.2%	$83.2	2.1%	10.9%	10.3%
$50,000 to $75,000........	-$16,304	-5.0%	$328.1	8.0%	$311.8	7.8%	14.5%	13.8%
$75,000 to $100,000......	-$13,075	-3.7%	$350.6	8.6%	$337.5	8.5%	16.5%	15.8%
$100,000 to $200,000.....	-$31,298	-2.6%	$1,197.4	29.3%	$1,166.1	29.3%	20.7%	20.2%
$200,000 to $500,000.....	-$21,229	-2.3%	$943.3	23.1%	$922.0	23.2%	26.5%	25.9%
$500,000 to $1,000,000..	-$10,493	-3.3%	$321.5	7.9%	$311.0	7.8%	30.8%	29.7%
$1,000,000 and over.......	-$5,471	-0.7%	$780.2	19.1%	$774.7	19.5%	32.1%	31.7%
Total, All Taxpayers......	**-$108,248**	**-2.6%**	**$4,091.1**	**100.0%**	**$3,982.8**	**100.0%**	**20.5%**	**19.9%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$4.664 billion to -$5.349 billion.

DISTRIBUTION EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017 (1)

Calendar Year 2027

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
							Present Law	Proposal
	Millions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000.........	-$444	-8.5%	$5.2	0.1%	$4.8	0.1%	4.7%	4.3%
$10,000 to $20,000........	-$1,835	(5)	-$3.4	-0.1%	-$5.2	-0.1%	-0.8%	-1.2%
$20,000 to $30,000........	-$3,238	-10.3%	$31.4	0.7%	$28.1	0.7%	4.1%	3.6%
$30,000 to $40,000........	-$4,336	-7.3%	$59.4	1.3%	$55.1	1.3%	7.6%	7.1%
$40,000 to $50,000........	-$6,922	-7.1%	$98.0	2.2%	$91.1	2.1%	11.0%	10.3%
$50,000 to $75,000........	-$21,575	-6.1%	$352.2	7.9%	$330.6	7.8%	14.5%	13.6%
$75,000 to $100,000......	-$19,082	-5.0%	$380.3	8.6%	$361.2	8.5%	16.3%	15.5%
$100,000 to $200,000.....	-$51,396	-3.9%	$1,302.4	29.3%	$1,251.0	29.4%	20.7%	19.8%
$200,000 to $500,000.....	-$40,557	-4.0%	$1,026.5	23.1%	$985.9	23.2%	26.6%	25.5%
$500,000 to $1,000,000..	-$17,755	-5.1%	$345.7	7.8%	$327.9	7.7%	30.8%	29.1%
$1,000,000 and over.......	-$23,439	-2.8%	$848.7	19.1%	$825.2	19.4%	32.1%	31.1%
Total, All Taxpayers......	**-$190,553**	**-4.3%**	**$4,446.4**	**100.0%**	**$4,255.8**	**100.0%**	**20.5%**	**19.6%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the $10,000 to $20,000 income category, Federal taxes would decrease from -$3.415 billion to -$5.250 billion.

DISTRIBUTIONAL EFFECTS OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Summary of Distribution Table

Distribution of Individual Income Tax Side of Table JCX-52-17

INCOME CATEGORY	CHANGE IN FEDERAL TAXES ($ millions)				
	2019	2021	2023	2025	2027
Less than $10,000............	-$124	-$69	-$75	-$37	-$144
$10,000 to $20,000............	-$917	-$775	-$758	-$662	-$1,047
$20,000 to $30,000............	-$1,587	-$1,546	-$1,712	-$1,586	-$1,860
$30,000 to $40,000............	-$2,814	-$2,746	-$2,736	-$2,584	-$2,589
$40,000 to $50,000............	-$3,981	-$4,140	-$4,223	-$4,236	-$4,538
$50,000 to $75,000............	-$14,493	-$14,566	-$14,295	-$14,196	-$13,784
$75,000 to $100,000..........	-$11,300	-$11,345	-$10,933	-$10,660	-$10,355
$100,000 to $200,000..........	-$27,457	-$26,837	-$24,096	-$22,543	-$20,375
$200,000 to $500,000..........	-$17,857	-$17,469	-$14,309	-$14,100	-$14,035
$500,000 to $1,000,000......	-$10,178	-$10,290	-$8,364	-$8,198	-$8,063
$1,000,000 and over...........	-$8,411	-$8,465	-$1,910	-$1,447	-$1,599
Total, All Taxpayers..........	**-$99,120**	**-$98,248**	**-$83,377**	**-$80,209**	**-$78,362**

Distribution of Business Tax Side

INCOME CATEGORY	CHANGE IN FEDERAL TAXES ($ millions)				
	2019	2021	2023	2025	2027
Less than $10,000............	-281	-182	41	-23	-300
$10,000 to $20,000............	-592	-307	220	-23	-789
$20,000 to $30,000............	-721	-552	-21	-270	-1,379
$30,000 to $40,000............	-977	-775	-129	-401	-1,746
$40,000 to $50,000............	-1,264	-1,084	-256	-594	-2,385
$50,000 to $75,000............	-4,352	-3,752	-1,064	-2,108	-7,792
$75,000 to $100,000..........	-5,402	-4,530	-1,293	-2,415	-8,727
$100,000 to $200,000..........	-19,829	-16,721	-4,813	-8,755	-31,021
$200,000 to $500,000..........	-19,898	-15,954	-3,478	-7,129	-26,522
$500,000 to $1,000,000......	-8,961	-6,684	-739	-2,296	-9,692
$1,000,000 and over...........	-24,806	-16,528	37	-4,024	-21,840
Total, All Taxpayers..........	**-87,083**	**-67,067**	**-11,495**	**-28,038**	**-112,191**

TOTAL DISTRIBUTION

INCOME CATEGORY	CHANGE IN FEDERAL TAXES ($ millions)				
	2019	2021	2023	2025	2027
Less than $10,000............	-405	-251	-35	-60	-444
$10,000 to $20,000............	-1,509	-1,082	-538	-685	-1,835
$20,000 to $30,000............	-2,308	-2,098	-1,733	-1,857	-3,238
$30,000 to $40,000............	-3,791	-3,521	-2,865	-2,986	-4,336
$40,000 to $50,000............	-5,245	-5,224	-4,480	-4,830	-6,922
$50,000 to $75,000............	-18,845	-18,317	-15,359	-16,304	-21,575
$75,000 to $100,000..........	-16,702	-15,875	-12,226	-13,075	-19,082
$100,000 to $200,000..........	-47,287	-43,558	-28,909	-31,298	-51,396
$200,000 to $500,000..........	-37,755	-33,423	-17,787	-21,229	-40,557
$500,000 to $1,000,000......	-19,138	-16,974	-9,103	-10,493	-17,755
$1,000,000 and over...........	-33,217	-24,993	-1,873	-5,471	-23,439
Total, All Taxpayers..........	**-186,203**	**-165,316**	**-94,873**	**-108,248**	**-190,553**

Source: Joint Committee on Taxation

NUMBER OF RETURNS BY INCOME CLASS

INCOME CATEGORY (2)	NUMBER OF TAXPAYER UNITS (thousands) (1)				
	2019	2021	2023	2025	2027
Less than $10,000............................	19,260	19,286	19,053	19,034	18,985
$10,000 to $20,000...........................	20,566	20,755	20,726	20,681	20,378
$20,000 to $30,000...........................	21,510	21,700	21,965	22,183	22,499
$30,000 to $40,000...........................	16,011	15,920	15,903	15,951	16,263
$40,000 to $50,000...........................	12,841	13,239	13,707	14,004	14,365
$50,000 to $75,000...........................	27,393	27,575	27,986	28,396	28,651
$75,000 to $100,000.........................	17,835	18,190	18,670	19,033	19,489
$100,000 to $200,000........................	30,667	31,169	31,869	32,622	33,332
$200,000 to $500,000........................	9,152	9,431	9,542	9,765	9,923
$500,000 to $1,000,000.....................	1,147	1,180	1,186	1,206	1,215
$1,000,000 and over..........................	572	584	594	611	629
Total, All Taxpayers.........................	176,955	179,029	181,201	183,485	185,726

Source: Joint Committee on Taxation

(1) Includes nonfilers, excludes dependent filers and returns with negative income.
(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

RE: Data

From: "Bailey, Bradley" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=7eb678b02d9b41c0af365038a082c58e-bailey, bradl">
To: "Reiser, Martin" <martin.reiser@mail.house.gov>
Date: Sun, 12 Nov 2017 10:31:10 -0500

Can you give me a quick call? [redacted]

From: Reiser, Martin <Martin.Reiser@mail.house.gov>
Date: November 12, 2017 at 10:29:07 AM EST
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>
Subject: RE: Data

Ok. [redacted]

From: Bradley.Bailey@treasury.gov [mailto:Bradley.Bailey@treasury.gov]
Sent: Sunday, November 12, 2017 10:27 AM
To: Reiser, Martin <Martin.Reiser@mail.house.gov>
Subject: Re: Data

[redacted]

From: Reiser, Martin <Martin.Reiser@mail.house.gov>
Date: November 11, 2017 at 8:33:19 AM EST
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>
Subject: Re: Data

[redacted]

Sent from my iPhone

On Nov 11, 2017, at 8:18 AM, "Bradley.Bailey@treasury.gov" <Bradley.Bailey@treasury.gov> wrote:

[redacted]

From: Reiser, Martin <Martin.Reiser@mail.house.gov>
Date: November 11, 2017 at 8:16:16 AM EST
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>
Subject: Re: Data

[redacted]

[redacted]

b(5) [redacted]

Sent from my iPhone

On Nov 11, 2017, at 8:09 AM, "Bradley.Bailey@treasury.gov" <Bradley.Bailey@treasury.gov> wrote:

> b(5) [redacted]
>
> ---
>
> **From:** Reiser, Martin <Martin.Reiser@mail.house.gov>
> **Date:** November 11, 2017 at 7:04:32 AM EST
> **To:** Bailey, Bradley <Bradley.Bailey@treasury.gov>
> **Subject:** Data
>
> b(5) [redacted]
>
> b(5) [redacted]
>
> Sent from my iPhone

FW: Simple calculator for comparing CL and HWM

From:	"Bailey, Bradley" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=7eb678b02d9b41c0af365038a082c58e-bailey, bradl">
To:	"Reiser, Martin" <martin.reiser@mail.house.gov>
Date:	Sun, 12 Nov 2017 10:57:56 -0500
Attachments:	CL and HWM Example Calculator 11072017 FINAL.XLSX (45.97 kB)

Here's the calculator

From: Bailey, Bradley
Sent: Wednesday, November 08, 2017 10:14 AM
To: 'Specht, Brittan' <Brittan.Specht@mail.house.gov>; 'donald.schneider@mail.house.gov' <donald.schneider@mail.house.gov>
Cc: 'Dunham, Will' <Will.Dunham@mail.house.gov>; Maloney, Drew <Drew.Maloney@treasury.gov>; b(6) [redacted]@treasury.gov>; b(6) [redacted]@treasury.gov>; Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: Simple calculator for comparing CL and HWM

Brittan / Donald:

In advance of our 1pm meeting, wanted to share the attached calculator that OTA has been working on. It allows the user to enter income, dependents, and deductions for each filing status (e.g., single, mfj) and from that information automatically computes tax liability. The income and deduction items can be customized for a state or congressional district using the taxpayer advocate or IRS data.

Brad

Brad Bailey
Deputy Assistant Secretary for Tax and Budget
Office of Legislative Affairs
U.S. Department of the Treasury
Bradley.bailey@treasury.gov
C: b(6) [redacted]
O: (202) 622-2878

SFC Winners and Losers Table

From: "Monie, Alex (Finance)" <alex_monie@finance.senate.gov>
To: Shahira Knight, EOP [redacted] "Muzinich, Justin" <justin.muzinich@treasury.gov>
Cc: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>
Date: Mon, 13 Nov 2017 08:07:00 -0500
Attachments: D-17-49.pdf (58.99 kB)

Shahira and Justin, Mark wanted you both to have a copy of the winners and losers tables. Let me know if you have any questions.

Best,

Alex

A DISTRIBUTION OF RETURNS BY THE SIZE OF THE TAX CHANGE FOR THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Calendar Year 2019

INCOME CATEGORY (2)	Percentage of Returns				
	Tax Decrease		Tax Change	Tax Increase	
	Greater Than $500	$100-$500	Less than $100	$100-$500	Greater Than $500
Less than $10,000..............	0.4%	3.3%	96.1%	0.1%	0.1%
$10,000 to $20,000............	1.3%	35.9%	61.1%	0.5%	1.2%
$20,000 to $30,000............	5.9%	39.8%	51.0%	1.0%	2.3%
$30,000 to $40,000............	22.6%	37.7%	35.0%	1.8%	2.9%
$40,000 to $50,000............	45.6%	26.1%	21.6%	2.9%	3.9%
$50,000 to $75,000............	63.3%	16.2%	11.0%	3.6%	5.9%
$75,000 to $100,000..........	70.2%	10.7%	4.7%	4.0%	10.4%
$100,000 to $200,000.........	73.2%	5.0%	2.3%	3.9%	15.6%
$200,000 to $500,000.........	72.2%	3.1%	1.4%	2.9%	20.4%
$500,000 to $1,000,000......	87.9%	0.5%	0.3%	0.5%	10.7%
$1,000,000 and over...........	81.6%	0.2%	0.2%	0.3%	17.7%
Total, All Taxpayers..........	**40.4%**	**19.3%**	**31.1%**	**2.3%**	**6.8%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) The categories reflecting the size of tax change are indexed for inflation.

A DISTRIBUTION OF RETURNS BY THE SIZE OF THE TAX CHANGE FOR THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Calendar Year 2021

INCOME CATEGORY (2)	Percentage of Returns				
	Tax Decrease		Tax Change	Tax Increase	
	Greater Than $500	$100-$500	Less than $100	$100-$500	Greater Than $500
Less than $10,000..............	0.3%	2.1%	97.3%	0.1%	0.1%
$10,000 to $20,000............	1.1%	28.3%	68.7%	0.6%	1.3%
$20,000 to $30,000............	4.7%	37.9%	53.9%	1.1%	2.4%
$30,000 to $40,000............	20.6%	35.5%	39.1%	2.0%	2.9%
$40,000 to $50,000............	43.9%	25.0%	23.7%	3.2%	4.2%
$50,000 to $75,000............	60.7%	16.5%	12.2%	4.0%	6.6%
$75,000 to $100,000..........	67.5%	11.5%	4.8%	4.5%	11.7%
$100,000 to $200,000.........	70.7%	5.2%	2.2%	4.3%	17.7%
$200,000 to $500,000.........	68.3%	3.5%	1.6%	2.9%	23.8%
$500,000 to $1,000,000......	85.1%	0.8%	0.3%	0.8%	13.0%
$1,000,000 and over...........	79.1%	0.3%	0.0%	0.2%	20.4%
Total, All Taxpayers..........	**38.7%**	**17.9%**	**33.1%**	**2.6%**	**7.7%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) The categories reflecting the size of tax change are indexed for inflation.

A DISTRIBUTION OF RETURNS BY THE SIZE OF THE TAX CHANGE FOR THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Calendar Year 2023

INCOME CATEGORY (2)	Percentage of Returns				
	Tax Decrease		Tax Change	Tax Increase	
	Greater Than $500	$100-$500	Less than $100	$100-$500	Greater Than $500
Less than $10,000..............	0.0%	2.0%	97.3%	0.4%	0.2%
$10,000 to $20,000............	0.5%	32.9%	61.1%	4.0%	1.4%
$20,000 to $30,000............	2.5%	39.0%	53.7%	2.5%	2.4%
$30,000 to $40,000............	13.7%	38.7%	41.1%	3.3%	3.2%
$40,000 to $50,000............	37.0%	27.5%	26.4%	4.2%	4.9%
$50,000 to $75,000............	54.0%	18.5%	14.3%	5.0%	8.2%
$75,000 to $100,000..........	60.8%	13.4%	6.1%	5.0%	14.7%
$100,000 to $200,000.........	64.2%	5.6%	2.7%	4.7%	22.7%
$200,000 to $500,000.........	59.2%	4.0%	1.8%	3.7%	31.3%
$500,000 to $1,000,000......	78.2%	0.8%	0.6%	1.0%	19.4%
$1,000,000 and over...........	72.7%	0.3%	0.3%	0.3%	26.3%
Total, All Taxpayers..........	**34.1%**	**19.6%**	**32.8%**	**3.7%**	**9.8%**

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) The categories reflecting the size of tax change are indexed for inflation.

A DISTRIBUTION OF RETURNS BY THE SIZE OF THE TAX CHANGE FOR THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Calendar Year 2025

INCOME CATEGORY (2)	Percentage of Returns				
	Tax Decrease		Tax Change	Tax Increase	
	Greater Than $500	$100-$500	Less than $100	$100-$500	Greater Than $500
Less than $10,000..............	0.1%	3.3%	96.1%	0.4%	0.2%
$10,000 to $20,000............	0.6%	33.6%	60.9%	3.5%	1.4%
$20,000 to $30,000............	2.0%	39.8%	52.7%	3.0%	2.5%
$30,000 to $40,000............	13.0%	38.5%	41.8%	3.4%	3.2%
$40,000 to $50,000............	36.0%	28.4%	26.5%	4.1%	5.1%
$50,000 to $75,000............	53.2%	19.2%	14.1%	5.1%	8.4%
$75,000 to $100,000..........	60.9%	13.3%	5.6%	5.1%	15.1%
$100,000 to $200,000.........	63.8%	5.7%	2.6%	4.7%	23.2%
$200,000 to $500,000.........	60.2%	3.5%	1.8%	3.7%	30.7%
$500,000 to $1,000,000......	78.2%	1.0%	0.7%	0.8%	19.3%
$1,000,000 and over...........	73.3%	0.3%	0.2%	0.3%	25.9%
Total, All Taxpayers..........	**34.0%**	**20.0%**	**32.2%**	**3.8%**	**10.0%**

Source: Joint Committee on Taxation
Detail may not add to total due to rounding.

(1) This table is a distributional analysis of the proposal in revenue table JCX-52-17, excluding the following sections: I. Tax Reform for Individuals: D.4.-D.6., and E.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) The categories reflecting the size of tax change are indexed for inflation.

TREAS-17-0313-I-000703

A DISTRIBUTION OF RETURNS BY THE SIZE OF THE TAX CHANGE FOR THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON NOVEMBER 13, 2017

Calendar Year 2027

INCOME CATEGORY (2)	Percentage of Returns				
	Tax Decrease		Tax Change Less than $100	Tax Increase	
	Greater Than $500	$100-$500		$100-$500	Greater Than $500
Less than $10,000..............	0.4%	6.3%	92.8%	0.3%	0.2%
$10,000 to $20,000............	1.4%	43.4%	50.7%	3.1%	1.5%
$20,000 to $30,000............	4.5%	41.9%	48.8%	2.4%	2.4%
$30,000 to $40,000............	21.3%	33.8%	38.7%	3.3%	2.9%
$40,000 to $50,000............	41.4%	26.2%	23.8%	4.1%	4.6%
$50,000 to $75,000............	57.2%	18.4%	11.9%	4.7%	7.7%
$75,000 to $100,000..........	65.6%	11.6%	4.6%	4.9%	13.3%
$100,000 to $200,000.........	68.4%	5.2%	2.4%	4.3%	19.6%
$200,000 to $500,000.........	68.0%	3.5%	1.6%	2.7%	24.3%
$500,000 to $1,000,000......	83.3%	0.6%	0.4%	0.7%	15.0%
$1,000,000 and over...........	77.9%	0.2%	0.2%	0.3%	21.5%
Total, All Taxpayers..........	**38.2%**	**20.6%**	**29.0%**	**3.4%**	**8.7%**

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RE: S-Corp Concerns with Senate Tax Reform Bill

From: b(6) [redacted]@treasury.gov>
To: "Plack, Brendon (Thune)" <brendon_plack@thune.senate.gov>
Cc: "Bailey, Bradley" <bradley.bailey@treasury.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Mon, 13 Nov 2017 10:37:30 -0500
Attachments: Pass Through counts and totals in HR1 tax brackets.xlsx (20.82 kB)

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Sent: Sunday, November 12, 2017 9:12 PM
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Hey b(6) [redacted] let's discuss this tomorrow morning if you have time. b(5) [redacted] b(5) [redacted] b(5) [redacted] I think I mentioned this to Drew as well last week.

Sent from my Verizon, Samsung Galaxy smartphone

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To: "Plack, Brendon (Thune)" <Brendon_Plack@thune.senate.gov>, "McBride, Stacy (Blunt)" <Stacy_McBride@blunt.senate.gov>, "Popp, Monica (Cornyn)" <Monica_Popp@cornyn.senate.gov>
Cc: Aric Newhouse <ANewhouse@nam.org>, "Suares, Erica (McConnell)" <Erica_Suares@mcconnell.senate.gov>
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Sr. Vice President – Government Relations
National Association of Wholesaler-Distributors
1325 G Street, NW, Suite 1000
Washington, DC 20005
Tel: 202-872-0885 Fax: 202-296-5940
www.naw.org

From: S Corporation Association [mailto:breardon@s-corp.org]
Sent: Saturday, November 11, 2017 6:08 PM
To: Jade West - NAW <jwest@naw.org>
Subject: S-Corp Concerns with Senate Tax Reform Bill

[redacted]

In This Issue

Are You A Member of S-Corp? Why Not?

S-CORP is the only trade association exclusively focused on representing S corporations before the Congress and the Executive Branch.

Our mission is to act as the "eyes, ears, *and* voice" of America's S corporations in Washington, D.C. Advocacy is all we do.

JOIN TODAY!

S-Corp Concerns with Senate Tax Reform Bill

Top Line

The Framework and rhetoric leading up to its release indicated that Senate Leadership and the Finance Committee were committed to treating the millions of companies organized as pass-through businesses fairly in relation to C corporations. The Framework explicitly called for a rate differential of five percentage points, while previous Finance Committee work focused on leveling the playing field between C corporations and pass-through businesses by eliminating the double corporate tax and moving the entire business community towards a single, reasonable level of tax on all businesses.

Unlike much of the business community, S-Corp fully supported *both* efforts and expressed that support publicly.

The tax bill released Thursday night falls well short of these promises and policies. It abandons any notion of equity for pass-through businesses. Under the plan, no successful pass-through business will receive the promised 25 percent rate or anything close to it, while the new, larger tax rate gap between pass-through businesses and C corporations will result in a migration of business activity out of the correct, single layer tax approach and into the harmful, double corporate tax. The economy will suffer as a result - there will be fewer jobs and less investment than if pass-through businesses could continue as a viable alternative for family businesses.

The new disparity of rates between individuals and C corporations will turn the C corporation into the tax avoidance vehicle of choice for wealthy taxpayers, returning the Tax Code to the pre-1986 Tax Reform Act days when C corporation rates were sharply lower than individual rates and tax gaming within the corporate structure was rampant.

Below are specific concerns and questions we have regarding the Senate bill. It was released late Thursday evening, so this is not a comprehensive list or review. S-Corp will continue to work with the Committee and members of the Senate to seek improvements and restore some semblance of parity between the tax treatment of C

corporations and S corporations.

Specific Concerns

Rate Differential: The bill reduces the top rate on C corporations to 20 percent. The bill reduces the top rate on S corporations to 38.5 percent, 18.5 points higher and 13.5 points above the promised rate in the Framework. The bill does include a deduction for pass-through businesses, if they have sufficient employees and payroll costs, of up to 17.4 percent, bringing the effective rate on qualifying pass-through businesses down to 32 percent, or 12 points above the C corporation rate. That is not the rate most S corporations will pay, however:

- SALT: The bill repeals the State and Local Tax Deduction for individuals and pass-through businesses. C corporations will continue to deduct SALT. Depending on which state(s) an S corporation resides in, the repeal of this business expense will increase the marginal rate of S corporations by as much as 5 percentage points. S corporations operating in California, therefore, will pay a marginal rate of 37 percent. The average S corporation will pay a marginal rate of around 34 percent, or 14 points above the C corporation rate.

- NIIT: Republican leadership promised to repeal the Net Investment Income Tax (NIIT) following the election of President Trump. This tax applies to income from S corporations earned by inactive shareholders. The failure of health care reform, coupled with the decision by leadership to not repeal the NIIT in tax reform, means marginal rates on S corporation income for inactive shareholders will be even 3.8 percentage points higher, resulting in a top marginal rate for S corporations of 40 percent or more.

- Revenues: The reason the pass-through rate is so much higher than the C corporation rate is the Committee chose to devote relatively more revenues to reducing the corporate rate. The JCT reports that the 20 percent corporate rate reduces revenues by $1,326 billion, whereas the pass-through deduction reduces revenues by just $460 billion, or 26 percent of the total revenue pool devoted to business rate relief. By way of comparison, pass-through businesses employ the majority of workers and earn the majority of business income. They represent approximately one-third of the American economy, not one-fourth.

- Fix: The Committee should devote a proportional amount of revenue to reducing the pass-through rate as it does to reducing the C corporation rate. At the very least, it should set as a goal maintaining the current maximum rate differential of approximately 9 percentage points between the two entity types.

Base Broadening: The Senate bill includes extensive base broadening, much of it affecting both C corporations and S corporations. But many of these base broadening provisions apply to pass-through businesses only, while all the base broadening will hurt S corporations more, since their marginal rate is so much higher than the C corporation rate. The loss of a $1 deduction will cost C corporations just 20 cents, whereas it will cost an S corporation up to 40 cents or more. Here are some of the significant base broadening provisions that will affect S corporations:

- Loss Limitation Rules: The Senate bill includes a wholly new limitation on "excess business losses of a taxpayer other than a C corporation..." There is little explanation as to why this provision is needed, necessary or even good policy. It would apply to active pass-through business income (not passive income) and it raises $176 billion over ten years. By way of background, the JCT references an existing limitation on losses by farmers who receive federal crop subsidies, yet this provision appears to have nothing to do with farms or subsidies. When you net this extra tax against the cost of the 17.4 percent deduction, the rate relief targeted at pass-through businesses drops to $284 billion, or just one-fifth the cost of the 20 percent corporate rate.

- SALT: The bill would repeal the State and Local Tax (SALT) deduction for individuals and pass-through businesses but not for C corporations. As noted above, this has the effect of raising marginal rates of pass-through businesses by up to 5 percentage points, exacerbating the rate differential between S and C corporations.

- Section 199: The bill would repeal the Section 199 deduction for production income, utilized by manufacturers and other producers. Four out of five manufacturers are organized as pass-through businesses. The deduction is up to 9 percent of production income, so it has the potential to reduce effective marginal tax rates by more than 3 percentage points. While the 199 repeal applies to both C corporations and pass-through businesses, the rate disparity between C corporations and pass-

through businesses means it will hit S corporations up to twice as hard.

- Repeal of Miscellaneous Deductions: These are a series of deductions that are only limited for individuals and pass-through businesses, including indirect and miscellaneous deductions from a pass-through business and deductible investment expenses from a pass-through entity. Preventing a partnership from deducting investment expenses can result in the partners paying taxes exceeding the returns on the investment. Needless to say, C corporations may continue to deduct their investment expenses.

- AMT: The Senate bill would repeal the individual Alternative Minimum Tax (AMT). This is a large benefit to pass-through businesses, since much of their income is taxed under the AMT rather than the regular code. The effect is muted if not fully offset, however, by the fact that the bill repeals many of the deductions restored by the AMT repeal. For example, pass-through businesses lose the SALT when their shareholders pay the AMT. Repealing the AMT restores their ability to deduct the SALT. The bill then repeals the SALT, but only for individuals and pass-through businesses, not C corporations. Combined, the base broadening in the Senate bill has the effect of turning the regular Tax Code into a new AMT, only at higher marginal rates.

- Fix: Strike the new limitation on active pass-through business income and allow pass-through businesses to deduct SALT.

International: The bill moves the tax code from a world-wide system to a modified territorial system (subject to the new GILTI regime). This new territorial system is reserved for C corporations only. S corporations and other pass-through entities are not included. This exclusion puts S corporations with overseas operations at a distinct disadvantage.

- Example: Under the bill, a C corporation with a CFC operating in the UK would pay the 20 percent UK corporate tax. Assuming no further inclusions under the GILTI regime, it would be able to pay the remainder back to the US with no additional tax. When the C corporation pays that income as a dividend to its shareholders, they would be taxed at 23.8 percent, but only those shareholders who pay taxes. Seventy-five percent of C corporation shareholders are tax advantaged - charities, endowments, qualified plans, foreigners, etc.

- S Corporations with branch operations in the UK would pay the 20 percent tax to the UK and then the US tax of 32-41 percent immediately (see section above) at the new pass-through tax rates. They would be allowed a Foreign Tax Credit for the taxes paid in the UK against their personal income, but this would be subject to limitations. There would be no opportunity to defer paying the US tax.

- Alternatively, an S corporation with a CFC would pay the 20 percent UK tax and its shareholders would be taxed at 23.8 percent on 100 percent of the dividend income when that is repatriated, regardless of whether the dividend was distributed to the shareholders. In other words, an S corporation with a CFC is treated worse than a C corporation CFC under the new territorial system.

- IC-DISC: The bill repeals the IC-DISC. This repeal has little effect on C corporations, as income qualifying for the new territorial system is taxed almost exactly as the IC-DISC system does now. The foreign earnings would be subject to foreign tax, and then a single additional layer of tax at the dividend rate when dividends are paid to the shareholder. The only difference would be that the dividends can be paid directly to the shareholder, rather than through the DISC. Since S corporations are excluded from the new territorial system, they will be harmed by this repeal. They lose the benefit of the DISC, but also are precluded from the benefits of territorial.

- Fix: The Senate bill should allow S corporations with CFCs to participate in territorial. The result would be IC-DISC-like treatment for all types of business operating overseas, with all of them having equal treatment. An alternative fix would be to preserve the IC-DISC for pass-through businesses.

Bottom Line

If enacted as introduced, the Senate bill would result in a large migration of business activity from the pass-through tax and into the double corporate tax. This migration would not result in better economic performance - the transition costs, the double tax imposed on a broader base of business income, and the change in behavior it would require on the part of converted family businesses will hurt economic growth, not help it.

Pass-through businesses employ the majority of workers, they earn the majority of business income, and they pay higher effective tax

rates than C corporations, yet they are literally being treated as an after-thought in this legislation.

The fix is for the Senate (and the House) to pursue tax reform that balances the importance of the pass-through community with the legitimate need to reduce the C corporation rate. S-Corp and its allies are willing and eager to work with the Committee and the full Senate to affect these changes.

Why Join S-Corp? Here's what our members say!

"S-Corp's strength is its ability to work with other business groups to support issues important to S corporations. They really are a leader and resource for other business groups in DC."

-Tom McMahon, Vice President of Operations, Barker Company

Calculator / PT Data

From: "Bailey, Bradley" <bradley.bailey@treasury.gov>

To: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, "Wrase, Jeff (Finance)" <jeff_wrase@finance.senate.gov>

Cc: "Maloney, Drew" <drew.maloney@treasury.gov>

Date: Mon, 13 Nov 2017 11:35:00 -0500

Attachments: Pass Through counts and totals in HR1 tax brackets.xlsx (20.82 kB); CL and HWM Example Calculator 11072017 FINAL.XLSX (45.97 kB)

Brad Bailey
Deputy Assistant Secretary for Tax and Budget
Office of Legislative Affairs
U.S. Department of the Treasury
Bradley.bailey@treasury.gov
C: b(6) [redacted]
O: (202) 622-2878

RE: S-Corp Concerns with Senate Tax Reform Bill

From: "Bailey, Bradley" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=7eb678b02d9b41c0af365038a082c58e-bailey, bradl">

To: "Plack, Brendon (Thune)" <brendon_plack@thune.senate.gov>, 'b(6) [redacted] <b(6) [redacted]@treasury.gov>

Cc: "Maloney, Drew" <drew.maloney@treasury.gov>

Date: Mon, 13 Nov 2017 12:00:14 -0500

Thank you very much. Will report back if there's anything of note

From: Plack, Brendon (Thune) [mailto:Brendon_Plack@thune.senate.gov]
Sent: Monday, November 13, 2017 11:57 AM
To: Bailey, Bradley <Bradley.Bailey@treasury.gov>; b(6) [redacted]@treasury.gov>
Cc: Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: RE: S-Corp Concerns with Senate Tax Reform Bill

b(5) [redacted]

From: Bradley.Bailey@treasury.gov [mailto:Bradley.Bailey@treasury.gov]
Sent: Monday, November 13, 2017 10:50 AM
To: b(6) [redacted]@treasury.gov; Plack, Brendon (Thune)
Cc: Drew.Maloney@treasury.gov
Subject: RE: S-Corp Concerns with Senate Tax Reform Bill

b(5) [redacted]

From: b(6) [redacted]
Sent: Monday, November 13, 2017 10:38 AM
To: 'Plack, Brendon (Thune)' <Brendon_Plack@thune.senate.gov>
Cc: Bailey, Bradley <Bradley.Bailey@treasury.gov>; Maloney, Drew <Drew.Maloney@treasury.gov>
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- Fix: Strike the new limitation on active pass-through business income and allow pass-through businesses to deduct SALT.

International: The bill moves the tax code from a world-wide system to a modified territorial system (subject to the new GILTI regime). This new territorial system is reserved for C corporations only. S corporations and other pass-through entities are not included. This exclusion puts S corporations with overseas operations at a distinct disadvantage.

- Example: Under the bill, a C corporation with a CFC operating in the UK would pay the 20 percent UK corporate tax. Assuming no further inclusions under the GILTI regime, it would be able to pay the remainder back to the US with no additional tax. When the C corporation pays that income as a dividend to its shareholders, they would be taxed at 23.8 percent, but only those shareholders who pay taxes. Seventy-five percent of C corporation shareholders are tax advantaged - charities, endowments, qualified plans, foreigners, etc.

- S Corporations with branch operations in the UK would pay the 20 percent tax to the UK and then the US tax of 32-41 percent immediately (see section above) at the new pass-through tax rates. They would be allowed a Foreign Tax Credit for the taxes paid in the UK against their personal income, but this would be subject to limitations. There would be no opportunity to defer paying the US tax.

- Alternatively, an S corporation with a CFC would pay the 20 percent UK tax and its shareholders would be taxed at 23.8 percent on 100 percent of the dividend income when that is

repatriated, regardless of whether the dividend was distributed to the shareholders. In other words, an S corporation with a CFC is treated worse than a C corporation CFC under the new territorial system.

- IC-DISC: The bill repeals the IC-DISC. This repeal has little effect on C corporations, as income qualifying for the new territorial system is taxed almost exactly as the IC-DISC system does now. The foreign earnings would be subject to foreign tax, and then a single additional layer of tax at the dividend rate when dividends are paid to the shareholder. The only difference would be that the dividends can be paid directly to the shareholder, rather than through the DISC. Since S corporations are excluded from the new territorial system, they will be harmed by this repeal. They lose the benefit of the DISC, but also are precluded from the benefits of territorial.

- Fix: The Senate bill should allow S corporations with CFCs to participate in territorial. The result would be IC-DISC-like treatment for all types of business operating overseas, with all of them having equal treatment. An alternative fix would be to preserve the IC-DISC for pass-through businesses.

Bottom Line

If enacted as introduced, the Senate bill would result in a large migration of business activity from the pass-through tax and into the double corporate tax. This migration would not result in better economic performance - the transition costs, the double tax imposed on a broader base of business income, and the change in behavior it would require on the part of converted family businesses will hurt economic growth, not help it.

Pass-through businesses employ the majority of workers, they earn the majority of business income, and they pay higher effective tax rates than C corporations, yet they are literally being treated as an after-thought in this legislation.

The fix is for the Senate (and the House) to pursue tax reform that balances the importance of the pass-through community with the legitimate need to reduce the C corporation rate. S-Corp and its allies are willing and eager to work with the Committee and the full Senate to affect these changes.

Why Join S-Corp? Here's what our members say!

"S-Corp's strength is its ability to work with other business groups to support issues important to S corporations. They really are a leader and resource for other business groups in DC."

-Tom McMahon, Vice President of Operations, Barker Company

RE: RE:

From: "Reiser, Martin" <martin.reiser@mail.house.gov>
To: "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Mon, 13 Nov 2017 14:29:28 -0500
Attachments: Collins, formatted.docx (1.07 MB)

b(5) [redacted]

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, November 13, 2017 2:25 PM
To: Reiser, Martin <Martin.Reiser@mail.house.gov>; Specht, Brittan <Brittan.Specht@mail.house.gov>
Subject: RE: RE:

Got it, is it something that is easily provided over email

From: Reiser, Martin [mailto:Martin.Reiser@mail.house.gov]
Sent: Monday, November 13, 2017 2:17 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>; Specht, Brittan <Brittan.Specht@mail.house.gov>
Subject: RE:

b(5) [redacted]

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, November 13, 2017 2:02 PM
To: Specht, Brittan <Brittan.Specht@mail.house.gov>; Reiser, Martin <Martin.Reiser@mail.house.gov>
Subject:

b(5) [redacted]

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

Re: RE: RE:

From: "Reiser, Martin" <martin.reiser@mail.house.gov>
To: "Maloney, Drew" <drew.maloney@treasury.gov>
Date: Mon, 13 Nov 2017 15:08:04 -0500

b(5) [redacted]

Sent from my iPhone

On Nov 13, 2017, at 2:56 PM, "Drew.Maloney@treasury.gov" <Drew.Maloney@treasury.gov> wrote:

b(5) [redacted]

From: Reiser, Martin [mailto:Martin.Reiser@mail.house.gov]
Sent: Monday, November 13, 2017 2:29 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Subject: RE: RE:

b(5) [redacted]

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, November 13, 2017 2:25 PM
To: Reiser, Martin <Martin.Reiser@mail.house.gov>; Specht, Brittan <Brittan.Specht@mail.house.gov>
Subject: RE: RE:

Got it, is it something that is easily provided over email

From: Reiser, Martin [mailto:Martin.Reiser@mail.house.gov]
Sent: Monday, November 13, 2017 2:17 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>; Specht, Brittan <Brittan.Specht@mail.house.gov>
Subject: RE:

b(5) [redacted]

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, November 13, 2017 2:02 PM
To: Specht, Brittan <Brittan.Specht@mail.house.gov>; Reiser, Martin <Martin.Reiser@mail.house.gov>
Subject:

b(5) [redacted]

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury

Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

Isakson 8 Tax markup amendments

From:	"McGuire, Monica (Isakson)" <monica_mcguire@isakson.senate.gov>
To:	"Bailey, Bradley" <bradley.bailey@treasury.gov>
Date:	Tue, 14 Nov 2017 00:39:13 -0500
Attachments:	Tax Reform Markup Amendments.docx (15.78 kB)

Brad, mtg tonight of SFC Rep tax LAs lasted till 11:00 pm! Modified mark to have delayed release around 4 pm. Thus not votes on amdts til Wed.

Sorry to not get our votes to you earlier. The last 2 amdts are placeholders.

Amdt #4 regrading locum tenets would be subject to the Byrd rule.
M3
Sent from my iPhone

Isakson Amendment #1 to the Tax Cuts and Jobs Act
Cosponsors: Scott, Crapo

Short Title: Nuclear Production Tax Credits

Description of Amendment: The amendment would modify the credit for production from advanced nuclear power facilities and remove the current expiration date of place in service before January 1, 2021, and create a new credit transfer provision regarding certain public entities. Specifically, the change would provide that certain public entities would be eligible to transfer NPTCs to specific project participants. The amendment would be effective for tax years beginning after date of enactment.

JCT Score: $400 million over 10 years (JCX-47-17)

Offset: To be provided.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #2 to the Tax Cuts and Jobs Act

Short Title: Transition Relief for Existing Foreign Branches

Description of Amendment: The Chairman's Mark generally exempts from tax dividends received by U.S. corporations from controlled foreign corporations. However, U.S. corporations operating as branches in foreign countries would continue to pay U.S. tax on the foreign branch's income. The amendment would allow an existing foreign branch operating an active business overseas to make a one-time, irrevocable election to treat such foreign branch as if it were a controlled foreign corporation under a territorial tax system. It also makes adjustments to the Code section 367 gain that would otherwise be recognized including a carve-out of locally-developed intangibles, and includes tax rates and installment payment periods used under deemed repatriation for tax due on such adjusted section 367 gain.

JCT Score: To be provided.

Offset: To be provided.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #3 to the Tax Cuts and Jobs Act

Short Title: Expand Eligibility for 100% Expensing

Description of Amendment: The Chairman's Mark extends the bonus depreciation provisions of Section 168(k) of the Internal Revenue Code through 2022 and increases the first-year deduction from 50 percent to 100 percent. Under current law, film, TV, and theatrical productions do not qualify for bonus depreciation, but a separate section (Section 181) provides special expensing rules for these productions. The amendment would allow film, TV, and theatrical productions to qualify for the temporary 100% expensing by changing the definition of qualified property eligible for bonus depreciation.

JCT Score: To be provided.

Offset: To be provided.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #4 to the Tax Cuts and Jobs Act

Short Title: Clarification of Treatment of Locum Tenens Physicians

Description of Amendment: The Chairman's Mark creates a safe harbor for treatment of independent contractors. The amendment clarifies the treatment of locum tenens physicians as independent contractors to help alleviate physician shortages in underserved areas.

JCT Score: To be provided.

Offset: To be provided, if needed.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #5 to the Tax Cuts and Jobs Act

Short Title: Repeal Exclusion Applicable to Certain Passenger Aircraft Operated by a Foreign Corporation

Description of Amendment: Section IV(G)(1) of the Chairman's Mark removes passenger cruise gross income from the reciprocal exemption under Section 883 of the Internal Revenue Code. The amendment would similarly remove certain passenger aircraft operated by a foreign corporation from Section 883. The restriction would apply to a foreign corporation headquartered in a foreign country that does not have an income tax treaty with the United States and that has fewer than two arrivals and departures from passenger airline carriers headquartered in the U.S.

JCT Score: To be provided, but the amendment is expected to raise revenue.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #6 to the Tax Cuts and Jobs Act

Short Title: Clarify Definition of Aggregate Foreign Cash Position for Business Acquisitions

Description of Amendment: The Chairman's Mark imposes a tax on deferred foreign income upon transition to the participation exemption system. The tax is imposed at a rate of 10 percent for aggregate earnings and profits attributable to cash assets, and 5 percent for those attributable to noncash assets. Aggregate earnings and profits attributable to cash assets are calculated as the greater of the cash position of the foreign corporation as of the end of 2017, or the average of the cash position as of the end of 2015 and 2016. The amendment would modify this calculation to reduce the 2015-2016 average by the amount of cash that a foreign corporation used to purchase substantially all of the assets of a trade or business from an unrelated person between the end of 2015 and November 9, 2017. The amendment would include a recapture provision that would impose a tax if the foreign corporation were to sell the acquired business for cash before the end of a specified holding period.

JCT Score: To be provided.

Offset: To be provided if needed.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #7 to the Tax Cuts and Jobs Act

Short Title: To improve the bill.

Description of Amendment: Section IV(D)(2) of the Mark addresses limitations on income shifting through intangible property transfers. The amendment would modify this section.

JCT Score: To be provided.

Offset: To be provided if needed.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

Isakson Amendment #8 to the Tax Cuts and Jobs Act

Short Title: To improve the bill.

Description of Amendment: Table 2 in Section I(A)(1) of the Chairman's Mark describes a new rate structure for individual income tax rates for 2018. In the last line of the section titled "Estates and Trusts," the amendment would strike "$3,077.50" and insert "$3,078."

JCT Score: To be provided.

Offset: To be provided if needed.

[NOTE – Amendment sponsor reserves the right to modify the amendment for technical, revenue neutrality, or other purposes.]

RE: tax reform

From: "Alber, Alexis (Ron Johnson)" <alexis_alber@ronjohnson.senate.gov>
To: "Riley, Sean (Ron Johnson)" <sean_riley@ronjohnson.senate.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>
Cc: [redacted]@treasury.gov>, "O'Neil, Jennifer (Ron Johnson)" <jennifer_o'neil@ronjohnson.senate.gov>, "Maloney, Drew" <drew.maloney@treasury.gov>, "McIlheran, Patrick (Ron Johnson)" <patrick_mcilheran@ronjohnson.senate.gov>
Date: Tue, 14 Nov 2017 09:59:46 -0500
Attachments: Sen. Johnson Business Tax Reform Summary.pdf (271.8 kB)

Hi Drew,

I look forward to working with you. [redacted]

[redacted]

[redacted]

[redacted]. Attached is the summary.

Please feel free to contact me with any questions.

Thanks,

Alexis J. Alber
Legislative Counsel
Senator Ron Johnson (WI)
328 Hart Senate Office Building
Washington, DC 20510

From: Riley, Sean (Ron Johnson)
Sent: Tuesday, November 14, 2017 9:11 AM
To: Drew.Maloney@treasury.gov
Cc: [redacted]@treasury.gov; O'Neil, Jennifer (Ron Johnson) <Jennifer_O'Neil@ronjohnson.senate.gov>; Drew.Maloney@treasury.gov; Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>
Subject: RE: tax reform

Hi, Drew—Adding Alexis Alber, our tax counsel.

Sean Riley
Legislative Director
Office of Senator Ron Johnson (WI)

(202) 224-5323

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Tuesday, November 14, 2017 8:32 AM
To: Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>
Cc: b(6) [redacted]@treasury.gov; O'Neil, Jennifer (Ron Johnson) <Jennifer_O'Neil@ronjohnson.senate.gov>
Subject: RE: tax reform

Sean,

b(5) [redacted]

Thanks

Drew

From: Riley, Sean (Ron Johnson) [mailto:Sean_Riley@ronjohnson.senate.gov]
Sent: Monday, November 13, 2017 2:41 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: b(6) [redacted] <b(6) [redacted]@treasury.gov>; O'Neil, Jennifer (Ron Johnson) <Jennifer_O'Neil@ronjohnson.senate.gov>
Subject: RE: tax reform

Thanks, Drew. Adding our Director of Operations.

Sean Riley
Legislative Director
Office of Senator Ron Johnson (WI)
(202) 224-5323

From: Drew.Maloney@treasury.gov [mailto:Drew.Maloney@treasury.gov]
Sent: Monday, November 13, 2017 2:08 PM
To: Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>
Cc: b(6) [redacted]@treasury.gov
Subject: tax reform

Sean,

Would like to schedule a meeting between our tax team and the Senator for this week. It would be our Assistant Secretary of Tax Policy, one of our counselors and myself.

Thanks

Drew

Drew Maloney
Assistant Secretary of the Treasury
Legislative Affairs
United States Department of the Treasury
1500 Pennsylvania Avenue, NW Suite 3134
Washington, DC 20220
Office: 202-622-1900
Cell: b(6) [redacted]
drew.maloney@treasury.gov

How to make America's corporate tax system the most competitive in the world

Many economists have shown that the burden of the corporate tax is borne by employees and consumers in the form of lower wages and higher prices. Instead of making employees and consumers pay the corporate tax, why not shift the burden to the owners?

Eighty-one percent of American businesses are Subchapter S or limited liability corporations — they operate as "pass through" entities for tax purposes. Their business income is attributed directly to the owners, and it is taxed on their individual tax returns. We should tax domestic income of C corporations at the ownership level as well. There would be a number of issues to resolve, but with modern accounting techniques and computing power, it is certainly possible to attribute C corp income to shareholders.

Once income (which I suggest should be defined as operational cash flow) is attributed, businesses would make a backup withholding payment equal to 25% for owner taxes — similar to what they currently do for payroll taxes. That would cover the vast majority of taxes owed by shareholders. To the extent that an individual's tax rates differ from the withheld rate, those individual taxpayers would claim a refund or pay the remaining tax due.

The required business tax withholding payment is, in effect, a forced dividend that eliminates the economically harmful double taxation of dividends and disincentives to repatriating overseas income. Because corporate income already will have been fully attributed to owners, additional dividend payments to shareholders could be distributed without incurring additional tax. This would dramatically increase the incentive for corporations to stop hoarding cash, to pay more dividends, and thereby to promote more efficient allocation of capital and greater economic growth.

There are many details to be developed, but here are the basic elements of the plan:

The definition of all domestic business taxable income (whether from a C corp, an S corp or an LLC) remains the same, with all common business deductions allowed (including interest deduction).

Worldwide cash flow would be included in taxable income. Companies would continue to claim a foreign tax credit for taxes remitted to foreign governments. This credit would be passed through to shareholders proportionally.

Corporations would establish a method to attribute taxable income to shareholders. I would suggest using a shareholders' days metric — the number of shares owned divided by portion of the year they are owned.

Taxable income would be attributed to each owner holding shares.

C corps would make a backup withholding tax payment on behalf of the owners to the IRS equal to 25% of taxable income on a quarterly basis.

C corp owners would receive an annual form, similar to a K-1, showing attributable income and the 25% backup withholding tax payment made on their behalf.

C corp owners would include attributable income in their individual taxable income — and would be able to claim the full backup withholding as a credit against their tax liability.

Tax-exempt shareholders, pension plans and foreign shareholders would not be allowed to claim backup withholding as a tax credit.

Because taxable income would be fully attributed and taxes would be paid by owners, no additional tax would be due on dividends paid to shareholders.

Dividend payments made would not be deducted from taxable income.

RON JOHNSON U.S. SENATE

RE: RJ

From: "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>
To: "Muzinich, Justin" <justin.muzinich@treasury.gov>
Date: Wed, 15 Nov 2017 22:28:42 -0500

b(5) [redacted]

Brendan M. Dunn
Policy Advisor and Counsel
Office of the Senate Majority Leader

From: Justin.Muzinich@treasury.gov [mailto:Justin.Muzinich@treasury.gov]
Sent: Wednesday, November 15, 2017 4:47 PM
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>; Drew.Maloney@treasury.gov
Subject: RE: RJ

b(5) [redacted]

From: Dunn, Brendan (McConnell) [mailto:Brendan_Dunn@mcconnell.senate.gov]
Sent: Wednesday, November 15, 2017 3:47 PM
To: Maloney, Drew <Drew.Maloney@treasury.gov>
Cc: Muzinich, Justin <Justin.Muzinich@treasury.gov>
Subject: RJ

b(5) [redacted]

Republican Sen. Ron Johnson Opposes GOP Senate Tax Package
Wisconsin Republican says plan unfairly benefits corporations over other businesses, says he finds bill's process 'offensive'
By Siobhan Hughes
Nov. 15, 2017 3:21 p.m. ET
The Wall Street Journal
https://www.wsj.com/articles/republican-sen-ron-johnson-opposes-gop-senate-tax-package-1510777290

WASHINGTON—Sen. Ron Johnson (R., Wis.) said he opposes the Senate Republican tax package, saying it unfairly benefits corporations more than other types of businesses.

"If they can pass it without me, let them," Mr. Johnson said in an interview. "I'm not going to vote for this tax package."

Mr. Johnson's position could undermine the Senate's efforts to pass a tax plan by early December or get the bill to President Donald Trump's desk by Christmas. Republicans are counting on near universal support from within the party to pass a bill on party line votes. With 52 seats in the Senate, Republicans can lose no more than two votes unless they can somehow find a way to win votes from Democrats.

Other Senate Republicans have expressed concerns. Jeff Flake of Arizona, for example, has worried about deficits and Susan Collins of Maine has worried about Republican plans to repeal the insurance coverage mandate in the Affordable Care Act as part of a tax overhaul.

Until now, no Senate Republican has come out definitively against the GOP tax plan. The risk for Senate Republican leaders is that other Republicans get behind Mr. Johnson's opposition. In addition to his concern about the details of the Republican proposal, he also complained about a process that he said has been closed to his input and also misleads the public about the nature of the tax overhaul.

"I don't like that process," Mr. Johnson said. "I find it pretty offensive, personally."

Mr. Johnson said Republican plans prioritize corporations over "pass-through" entities—sole proprietorships, partnerships, limited liability companies and S Corporations—whose owners pay taxes through individual returns and at individual income-tax rates, rather than corporate rates. The Senate plan, like the House plan, proposes to cut the corporate rate from 35% to 20%.

Top rates for pass-through filers would remain over 30% in the Senate version of the bill and the House bill substantially constrains how much pass-through income could be taxed at a new 25% rate.

The Senate bill would provide $1.3 trillion in gross tax rate cuts to corporations, according to the Joint Committee on Taxation. That compares to $362 billion in gross tax cuts for pass-through entities. Both types of businesses also would lose some tax breaks. More companies are organized as pass-through businesses than as corporations. Many pass-through filers are small businesses. Overall U.S. business income is split roughly evenly between the pass-through businesses and corporate income.

"I have no problems in making all American businesses competitive globally," Mr. Johnson said. "This isn't anti-big corporation at all. When you're going to do a tax reform, you have to treat them equitably so they can maintain their competitive position here at home as we're making them competitive globally."

Brendan M. Dunn
Policy Advisor and Counsel
Office of the Senate Majority Leader

RE: b(5) [redacted]

From: "Alber, Alexis (Ron Johnson)" <alexis_alber@ronjohnson.senate.gov>

To: "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, "Kowalski, Daniel" <daniel.kowalski@treasury.gov>, "Khosla, Jay (Finance)" <jay_khosla@finance.senate.gov>, "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>

Cc: "Wrase, Jeff (Finance)" <jeff_wrase@finance.senate.gov>, Shahira Knight, EOP [redacted], "Popp, Monica (Cornyn)" <monica_popp@cornyn.senate.gov>, "Soderstrom, Sharon (McConnell)" <sharon_soderstrom@mcconnell.senate.gov>, "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>, "Blando, Tony (Ron Johnson)" <tony_blando@ronjohnson.senate.gov>, "Riley, Sean (Ron Johnson)" <sean_riley@ronjohnson.senate.gov>, "McIlheran, Patrick (Ron Johnson)" <patrick_mcilheran@ronjohnson.senate.gov>, "Oman, Eric (Finance)" <eric_oman@finance.senate.gov>

Date: Sat, 18 Nov 2017 20:02:30 -0500

Dan,

Per Mark's recommendation, below are my notes regarding data Sen. Johnson has requested from Treasury.

1. b(5) [redacted] b(5) [redacted]
2. b(5) [redacted] b(5) [redacted]
    - b(5) [redacted]
    - [redacted]
3. b(5) [redacted] b(5) [redacted]
4. b(5) [redacted]
5. [redacted]
6. b(5) [redacted] b(5) [redacted]
7. b(5) [redacted]
8. b(5) [redacted] b(5) [redacted]
9. b(5) [redacted] b(5) [redacted]
10. b(5) [redacted]

b(5) [redacted]

11. b(5) [redacted]

b(5) [redacted]

From: Prater, Mark (Finance)
Sent: Saturday, November 18, 2017 7:22 PM
To: Daniel.Kowalski@treasury.gov; Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira Knight, EOP [redacted] Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

I transmitted Sen. Johnson's requests to JCT, on behalf of SFC staff, late yesterday afternoon. I discussed it with Tom Barthold this morning. There is some data available that profiles business entities in the pamphlet JCT published for our hearing. Here's the link:
https://www.jct.gov/publications.html?func=startdown&id=5021

I don't know if all of the 11 JCT requests have been shared with Treasury, but I'd be glad to do so if your office agrees.

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Saturday, November 18, 2017 5:45 PM
To: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>Shahira Knight, EOP [redacted] Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

b(5) [redacted]

From: Khosla, Jay (Finance) [mailto:Jay_Khosla@finance.senate.gov]
Sent: Saturday, November 18, 2017 11:35 AM
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira E. EOP/WHO Knight Shahira Knight, EOP [redacted]>; Kowalski, Daniel <Daniel.Kowalski@treasury.gov>; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson)

<Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: Re: b(5) [redacted]

+ Eric Oman.

On Nov 18, 2017, at 11:00 AM, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov> wrote:

> Adding Finance
>
> ---
>
> **From:** Alexis Alber <Alexis_Alber@ronjohnson.senate.gov>
> **Date:** Saturday, November 18, 2017 at 10:30 AM
> **To:** Brendan Dunn <Brendan_Dunn@mcconnell.senate.gov>, Jeffrey Wrase <Jeff_Wrase@finance.senate.gov>, Shahira Knight Shahira Knight, EOP [redacted]>, Daniel Kowalski <Daniel.Kowalski@treasury.gov>, Monica Popp <Monica_Popp@cornyn.senate.gov>, Sharon Soderstrom <Sharon_Soderstrom@mcconnell.senate.gov>
> **Cc:** Tony Blando <Tony_Blando@ronjohnson.senate.gov>, Sean Riley <Sean_Riley@ronjohnson.senate.gov>, Patrick McIlheran <Patrick_McIlheran@ronjohnson.senate.gov>
> **Subject:** b(5) [redacted]
>
> Good morning,
>
> b(5) [redacted]
>
> Thanks,
>
> Alexis
>
> Sent from my iPhone

Re: b(5) [redacted]

From: "Muzinich, Justin" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=3d2afce60d7e464fbd30ff8dbedefecb-muzinich, jus">

To: "Alber, Alexis (Ron Johnson)" <alexis_alber@ronjohnson.senate.gov>, "Kowalski, Daniel" <daniel.kowalski@treasury.gov>

Cc: "Kautter, David" <david.kautter@treasury.gov>, "Popp, Monica (Cornyn)" <monica_popp@cornyn.senate.gov>, "Riley, Sean (Ron Johnson)" <sean_riley@ronjohnson.senate.gov>, "Wrase, Jeff (Finance)" <jeff_wrase@finance.senate.gov>, "Mcllheran, Patrick (Ron Johnson)" <patrick_mcilheran@ronjohnson.senate.gov>, "Acuna, Jennifer (Finance)" <jennifer_acuna@finance.senate.gov>, "Blando, Tony (Ron Johnson)" <tony_blando@ronjohnson.senate.gov>, "Soderstrom, Sharon (McConnell)" <sharon_soderstrom@mcconnell.senate.gov>, "Prater, Mark (Finance)" <mark_prater@finance.senate.gov>, "Khosla, Jay (Finance)" <jay_khosla@finance.senate.gov>, "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>, shahira.e.knight@who.eop.gov, "Oman, Eric (Finance)" <eric_oman@finance.senate.gov>, "Mackie, James III" <b(6) [redacted] @treasury.gov>

Date: Sun, 19 Nov 2017 07:38:50 -0500

Thanks Dan and Alexis. The team is working on answers to your questions, including the list from yesterday that was also sent to JCT. Some is a bit of a lift, so we will do our best to send you what we have by end of day Monday, and the rest will follow after that.

From: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>
Date: November 18, 2017 at 10:26:44 PM EST
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Cc: Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>, Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>, Muzinich, Justin <Justin.Muzinich@treasury.gov>, Mackie, James III <b(6) [redacted] @treasury.gov>, Kautter, David <David.Kautter@treasury.gov>, Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>, Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>, Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>, Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>, Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>, Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>, Shahira Knight, EOP [redacted] Shahira Knight, EOP [redacted]>, Mcllheran, Patrick (Ron Johnson) <Patrick_Mcllheran@ronjohnson.senate.gov>, Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>
Subject: Re: b(5) [redacted]

Thanks Dan, appreciate the help.

Sent from my iPhone

On Nov 18, 2017, at 10:19 PM, "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov> wrote:

b(5) [redacted]

I have included other Treasury personnel regarding the detailed data you are requesting.

From: Alber, Alexis (Ron Johnson) [mailto:Alexis_Alber@ronjohnson.senate.gov]

Sent: Saturday, November 18, 2017 9:25 PM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>; Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira Knight, EOP [redacted]; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

Thank you Dan. As a follow up, the senator has additional questions.

b(5) [redacted]

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Saturday, November 18, 2017 5:45 PM
To: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira Knight, EOP [redacted]; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

b(5) [redacted]

From: Khosla, Jay (Finance) [mailto:Jay_Khosla@finance.senate.gov]
Sent: Saturday, November 18, 2017 11:35 AM
To: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira E. EOP/WHO Knight <Shahira Knight, EOP [redacted]>; Kowalski, Daniel <Daniel.Kowalski@treasury.gov>; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson)

<Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson)
<Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: Re: b(5) [redacted]

+ Eric Oman.

On Nov 18, 2017, at 11:00 AM, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov> wrote:

> Adding Finance
>
> ---
>
> **From:** Alexis Alber <Alexis_Alber@ronjohnson.senate.gov>
> **Date:** Saturday, November 18, 2017 at 10:30 AM
> **To:** Brendan Dunn <Brendan_Dunn@mcconnell.senate.gov>, Jeffrey Wrase <Jeff_Wrase@finance.senate.gov>, Shahira Knight Shahira Knight, EOP [redacted]>, Daniel Kowalski <Daniel.Kowalski@treasury.gov>, Monica Popp <Monica_Popp@cornyn.senate.gov>, Sharon Soderstrom <Sharon_Soderstrom@mcconnell.senate.gov>
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> **Subject:** b(5) [redacted]
>
> Good morning,
>
> b(5) [redacted]
>
> Thanks,
>
> Alexis
>
> Sent from my iPhone

RE: b(5) [redacted]

From: "Kowalski, Daniel" <"/o=ustreasury/ou=exchange administrative group (fydibohf23spdlt)/cn=recipients/cn=cf6b4ee3710f422fbceecb0020766838-kowalski, dan">
To: "Popp, Monica (Cornyn)" <monica_popp@cornyn.senate.gov>
Cc: "Dunn, Brendan (McConnell)" <brendan_dunn@mcconnell.senate.gov>
Date: Mon, 20 Nov 2017 11:23:41 -0500

Not at all, as long as you include the same caveats b(5) [redacted]

From: Popp, Monica (Cornyn) [mailto:Monica_Popp@cornyn.senate.gov]
Sent: Monday, November 20, 2017 11:20 AM
To: Kowalski, Daniel <Daniel.Kowalski@treasury.gov>
Cc: Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Subject: Re: b(5) [redacted]

Dan – Would you mind if we shared this estimate with Daines' office as well?

From: "Daniel.Kowalski@treasury.gov" <Daniel.Kowalski@treasury.gov>
Date: Saturday, November 18, 2017 at 10:19 PM
To: "Alber, Alexis (Ron Johnson)" <Alexis_Alber@ronjohnson.senate.gov>, Jay Khosla <Jay_Khosla@finance.senate.gov>, "Dunn, Brendan (McConnell)" <Brendan_Dunn@mcconnell.senate.gov>
Cc: "Wrase, Jeff (Finance)" <Jeff_Wrase@finance.senate.gov>, "Shahira Knight, EOP [redacted]" Shahira Knight, EOP [redacted]>, Monica Popp <Monica_Popp@cornyn.senate.gov>, Sharon Soderstrom <Sharon_Soderstrom@mcconnell.senate.gov>, "Prater, Mark (Finance)" <Mark_Prater@finance.senate.gov>, "Acuna, Jennifer (Finance)" <Jennifer_Acuna@finance.senate.gov>, "Blando, Tony (Ron Johnson)" <Tony_Blando@ronjohnson.senate.gov>, "Riley, Sean (Ron Johnson)" <Sean_Riley@ronjohnson.senate.gov>, "McIlheran, Patrick (Ron Johnson)" <Patrick_McIlheran@ronjohnson.senate.gov>, "Oman, Eric (Finance)" <Eric_Oman@finance.senate.gov>, "b(6) [redacted]@treasury.gov" <b(6) [redacted]@treasury.gov>, "Justin.Muzinich@treasury.gov" <Justin.Muzinich@treasury.gov>, "David.Kautter@treasury.gov" <David.Kautter@treasury.gov>
Subject: RE: b(5) [redacted]

b(5) [redacted]

I have included other Treasury personnel regarding the detailed data you are requesting.

From: Alber, Alexis (Ron Johnson) [mailto:Alexis_Alber@ronjohnson.senate.gov]
Sent: Saturday, November 18, 2017 9:25 PM
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<Brendan_Dunn@mcconnell.senate.gov>
Cc: Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira Knight, EOP [redacted]; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

Thank you Dan. As a follow up, the senator has additional questions.

b(5) [redacted]

From: Daniel.Kowalski@treasury.gov [mailto:Daniel.Kowalski@treasury.gov]
Sent: Saturday, November 18, 2017 5:45 PM
To: Khosla, Jay (Finance) <Jay_Khosla@finance.senate.gov>; Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov>
Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov> Shahira Knight, EOP [redacted] Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: RE: b(5) [redacted]

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Cc: Alber, Alexis (Ron Johnson) <Alexis_Alber@ronjohnson.senate.gov>; Wrase, Jeff (Finance) <Jeff_Wrase@finance.senate.gov>; Shahira E. EOP/WHO Knight Shahira Knight, EOP [redacted]>; Kowalski, Daniel <Daniel.Kowalski@treasury.gov>; Popp, Monica (Cornyn) <Monica_Popp@cornyn.senate.gov>; Soderstrom, Sharon (McConnell) <Sharon_Soderstrom@mcconnell.senate.gov>; Prater, Mark (Finance) <Mark_Prater@finance.senate.gov>; Acuna, Jennifer (Finance) <Jennifer_Acuna@finance.senate.gov>; Blando, Tony (Ron Johnson) <Tony_Blando@ronjohnson.senate.gov>; Riley, Sean (Ron Johnson) <Sean_Riley@ronjohnson.senate.gov>; McIlheran, Patrick (Ron Johnson) <Patrick_McIlheran@ronjohnson.senate.gov>; Oman, Eric (Finance) <Eric_Oman@finance.senate.gov>
Subject: Re: C Corp SALT score

+ Eric Oman.

On Nov 18, 2017, at 11:00 AM, Dunn, Brendan (McConnell) <Brendan_Dunn@mcconnell.senate.gov> wrote:

> Adding Finance
>
> ---
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> **From:** Alexis Alber <Alexis_Alber@ronjohnson.senate.gov>
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> **Subject:** b(5) [redacted]
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> Thanks,
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